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THE INTERNATIONAL MONETARY SITUATION AND THE ADMINISTRATION'S OIL FLOOR PRICE PROPOSAL

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HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-FOURTH CONGRESS

FIRST SESSION

MARCH 24 AND APRIL 28, 1975

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THE INTERNATIONAL MONETARY SITUATION AND THE ADMINISTRATION'S OIL FLOOR PRICE PROPOSAL

MONDAY, MARCH 24, 1975

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INTERNATIONAL ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Henry S. Reuss (chairman of the subcommittee) presiding.

Present: Representatives Reuss and Hamilton.

Also present: John R. Karlik and Sarah Jackson, professional staff members; and Michael J. Runde, administrative assistant.

Chairman REUSS. Good morning. The Subcommittee on International Economics of the Joint Economic Committee will be in order.

This morning we welcome again as witnesses before the subcommittee the Secretary of the Treasury, William E. Simon, accompanied by the Under Secretary for Monetary Affairs, Jack F. Bennett.

Would you identify your associate?

Secretary SIMON. Mr. Charles Cooper, Assistant Secretary, Mr. Chairman.

Chairman REUSS. Welcome, sir. We always appreciate the Secretary of the Treasury's candor and helpfulness. Our examination this morning will focus on four major subjects: The outlook for international monetary reform, U.S. policies regarding gold, intervention in exchange markets by the U.S. monetary authorities, and the international energy policy.

This is a lot of ground to cover and an extensive list of questions has already been made available to the witnesses in the statement announcing these hearings.

Your statement, Secretary Simon, which I have had an opportunity to read over the weekend, is most helpful and gives us a good overview of where we are.

Please proceed.

STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY, ACCOMPANIED BY JACK F. BENNETT, UNDERSECRETARY OF THE TREASURY FOR MONETARY AFFAIRS; AND CHARLES A. COOPER, ASSISTANT SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS

Secretary SIMON. Thank you, Mr. Chairman. There is a great deal of discussion these days about the international monetary situation and the position of the dollar and many suggestions about what policies the United States should follow in present circumstances.

I am pleased to have this opportunity to give you my views on this subject, and to outline the status of international discussions of amendments to the IMF articles that have important implications for the future evolution of the monetary system.

RECENT EXCHANGE MARKET DEVELOPMENTS AND PROSPECTS FOR THE FUTURE

I am sure the subcommittee is aware that in recent months the price of the dollar decreased in terms of several European currencies. I am sure you have also heard the views of some who argue that this movement should be countered by large-scale intervention to peg the dollar at a particular rate or zone, or by an offer by the United States and the IMF to replace foreign dollar holdings with newly created SDR's, or by other direct measures.

I disagree with these proposals, and I disagree with the assessments on which they are based. Let me try to place recent exchange rate movements in their proper perspective.

While there have been changes in terms of a number of European currencies, the particular exchange rate movements that have attracted the greatest attention are two—the changes of the Swiss franc and the German mark relative to the dollar.

Since last September the change in the dollar exchange rate for these two currencies has indeed been large: Almost 23 percent for the Swiss franc and almost 16 percent for the German mark.

But three points should be borne in mind. First, looking at present rates just in relation to rates prevailing last September exaggerates the movements that have occurred.

Present dollar rates for these two currencies are much closer to previous highs than this comparison suggests: The Swiss franc is only 10 percent above its previous high relative to the dollar; the German mark remains slightly below its earlier high point in terms of the dollar. Second, while these two currencies have been strengthening relative to the dollar, and the Swiss and German monetary authorities have been buying dollars, the dollar has also been rising relative to certain other currencies, and their authorities have been selling dollars.

In some cases, they have been borrowing dollars to sell in the market to support the rate and, thus, there has been market intervention by foreign governments on both sides of the market—and, in effect, many of the dollars bought by the Swiss and German authorities have been sold by other foreign governments whose exchange rates have been under downward pressure.

Third, the Swiss and German currencies have also increased significantly in value against other major currencies as well as the dollar, and it is legitimate to ask to what extent the changes vis-a-vis the dollar reflect a weakening of the dollar or a general strengthening of these two other currencies.

Movements of the dollar or any currency must be looked at against a broad background. They must be examined over a longer period than just a few months and measured against the full range of other major currencies rather than just one or two—for example, by measuring changes on an average basis against a number of currencies.

Looked at in the broader context, the dollar does not show a large or continuous depreciation nor great instability. Several tables and a chart attached to my statement illustrate this point.[1] These show that:

On a trade-weighted average basis against all OECD currencies as a group, the dollar stands approximately where it was 2 years ago when generalized floating began. Moreover, the dollar has been one of the most stable of the major currencies during this period.

On the same basis, while the dollar declined from last September to mid-February, that decline followed an equally large increase in the dollar's value in the preceding few months, so that there has been no significant net change since last spring.

It is of importance to recognize and understand what factors influenced the exchange rate moves during September to mid-February—and there are a number of factors—neither mysterious nor alarming, which tended toward a weakening of the dollar in that period:

First, as is also shown in one of the attached tables to my statement, there have been substantial changes in relative interest rates as between the United States and other financial centers. Interest rate reductions here have been in advance of reductions elsewhere and, given the depth of the recession in the United States, the yield on short-term instruments declined much more sharply in the United States than in most other countries in the period from September through January.

Such cyclical differences in interest rates can have an important influence on capital flows.

Second, since mid-1974 there has been a natural and healthy correction of earlier expectations that the United States would receive a greatly disproportionate share of the investments made by oil exporters. Such expectations probably pushed the dollar up last summer, and a readjustment based on a more reasonable assessment has taken place.

Third, some elements of the U.S. current account balance of payments were not as strong in the latter part of 1974 and in the early months of 1975 as they were earlier. With lower world commodity prices and slack economic conditions abroad, for example, some moderation of our agricultural and raw materials exports was to be expected.

As a footnote to this point, however, I would urge that a great deal more caution be exercised in interpreting balance-of-payments statistics. Just last week, the press highlighted a figure in a Government press release which indicated that the deficit in our balance on current and long-term capital transactions had risen to $10.6 billion in 1974

[1] See tables and chart, pp. 10 and 11.

from a $1 billion deficit in 1973. This was a highly misleading interpretation of our balance-of-payments situation.

This particular balance is constructed in such a way that it excludes most of the identified investments in the United States by the oil exporting countries—totaling about $11 billion in 1974. Adding in these investments would eliminate the whole deficit; careful judgment must be exercised in interpreting these statistics, and revisions to provide for a more meaningful presentation of balance-of-payments numbers are under study.

Fourth, there has undoubtedly been some fear that expansionary policies in the United States might lead to a resurgence in inflation, and a recognition in exchange markets that our performance has not in the past been as good as that of Germany and Switzerland.

Prospective massive Treasury borrowings this year, and the possibility of excessive tax reductions and expenditure increases, call into question our dedication to the struggle against inflation, and raise the possibility that a new round of inflation will halt the process of economic recovery.

In addition to these primary influences, Middle East political developments may well have had some impact. And several other factors have probably had a minor, short-run influence—for example, talk of oil price indexation; and actions taken by Iran, Saudia Arabia, and a few others to "peg" their currencies to the SDR rather than the dollar, even though these moves were designed to moderate the effect of exchange rate fluctuations on domestic prices in those countries, and have no direct implication for exchange rates for the dollar.

What of the future? The dollar has strengthened slightly in the last few weeks, and, looking ahead, there are a number of factors which suggest that the prospects for the dollar are reasonably strong:

First: The U.S. lead in reducing interest rates may be ending, as is suggested by some of the most recent figures in the attached table. As recession bottoms out and our domestic demand strengthens in the months ahead, incentives for interest-sensitive flows could be reversed by a further change in international interest rate differentials.

Second: While the oil producers have been diversifying their investments geographically, which is a healthy and natural contribution to "recycling," the United States is likely to continue to receive a significant share of these investments directly and indirectly—perhaps a higher share in coming months than were received in the last few.

Third: Our competitive position is strong. There are probably still some residual effects of the 1971 and 1973 devaluations. More importantly, the United States performance on inflation, bad as it has been, is nonetheless better than that of most other countries.

If the Congress will cooperate with the administration in holding the line on tax reductions and expenditure increases, we can continue to do better in the future. This is of fundamental importance.

U.S. EXCHANGE RATE POLICIES

Against the background of these developments and in light of our domestic requirements and international objectives, what policies should the United States adopt with respect to exchange rates?

My views can be stated simply. I believe that for a sound dollar, the main imperative is to concentrate not on exchange markets and exchange rates, which are a product of our economic policies and performance, but on assuring the strength of the U.S. economy. In a very basic sense, the United States does have a serious "exchange rate" problem—and that is the continuous decline of the dollar, not in terms of foreign currency, but in terms of its purchasing power, or its exchange rate against goods and services in general.

We have not done well in maintaining that particular exchange rate. Our inflation record is not one to be proud of. We have not done a good job of defending the dollar against the devaluation and depreciation in purchasing power which inflation brings. Undoubtedly the prestige of the dollar has suffered.

The way to achieve greater stability in the dollar's value is not through governmental intervention or controls to maintain a particular rate or pattern of rates in the foreign exchange markets. Such measures in a sense are like price controls over one sector of our economy—the international sector—which would introduce rigidities into the system and would be positively damaging. They would exacerbate our longer term problems and would be of doubtful value even in terms of shorter run exchange market objectives.

We must bring our inflation under control and do a better job of reducing the depreciation of the dollar in terms of the goods and services it can buy. This is the only true "defense of the dollar," and improving the strength and stability of the U.S. domestic economy is the single most important contribution we can make to a strong international economy, as well as to our own economic health and well-being.

Accordingly, I regard policies which look toward the establishment of foreign exchange rate pegs, targets, or zones as unwise. Such policies focus on the symptoms rather than the sources of our troubles—on effects rather than causes.

The world moved to the present arrangements of "managed floating" for very good reasons—we needed greater flexibility and greater reliance on market forces at a time of great uncertainty. Those conditions still exist, and monetary arrangements which allow a considerable scope for market forces are especially well suited to present circumstances.

These arrangements have served us well in enabling the world economy to absorb some rather severe shocks in the past 2 years without the crises of earlier years.

There are some economists who take the view that the foreign exchange rate "doesn't matter" as far as a nation's balance of payments is concerned. While everyone acknowledges that exchange rate movements have some effect on domestic prices, this group contends that any exchange rate change stimulates prompt and full offsetting adjustments in domestic price levels, and thus has no lasting impact on international payments.

I do not accept that extreme view. The exchange rate is a major economic variable which does facilitate balance-of-payments adjustment among countries and contributes to a smooth functioning of the international economy. When I express doubts about exchange rate

pegs or zones, this does not indicate a policy of "benign neglect" or a belief that exchange rates have no effect. Rather, it reflects a conviction that those techniques do not best serve the need for balance-of-payments adjustment and a smoothly functioning international economy.

With widespread floating, international cooperation on exchange practices remains essential, although the form of cooperation may differ from that in a par value world. Our attention, and that of the rest of the world community, should not be concentrated on specific exchange rates of individual currencies, but rather on assuring that the exchange system is not disrupted and disorderly.

This calls for a code of good conduct to assure that all countries—those floating as well as those attempting to maintain established pegs or zones for their currencies—avoid beggar-thy-neighbor practices. And it may call for cooperative approaches on intervention to maintain these orderly markets.

The United States has joined with others in stating its willingness to cooperate in intervention in particular situations where such intervention is useful and appropriate for maintaining orderly markets.

There has, indeed, been a significant amount of such market intervention in recent months—since last September total market intervention by the United States has amounted to slightly more than $1 billion.

Another element of the U.S. policy which has a major influence on the strength of the dollar is our policy toward foreign investment. I mentioned earlier that there has been somewhat greater diversification in the oil exporter investments than was apparent or widely expected earlier last year. Such a shift in the flows and in public anticipation was to be expected.

It can facilitate resolution of the world's oil-related financing problems and need not have adverse implications for the dollar. I do not subscribe to the view which has been put forward that there has been a major shift in portfolio preference on the part of the oil producers which would place continuing downward pressure on our dollar.

In the immediate wake of the oil price increases, initial investments were placed heavily in dollar instruments, and heavily at short term. As accumulations and experience grew, greater diversification occurred—in currencies, maturities, and types of investment—spurred on, undoubtedly, by interest rate changes in the United States and abroad.

This diversification enhances the ability of other countries to obtain needed financing directly and reduces the need for the U.S. banking system to play an intermediary role.

At the same time, a very high proportion of the investments by oil exporters remains denominated in dollars. The United States has received a reasonable share of these investments. We welcome these investments. We have a large, efficient, and very attractive capital market. We wish to keep it that way.

I have made clear that the administration has no intention of imposing capital controls—on inward or outward flows. We have testified that we are confident that the Government already possesses ade-

quate safeguards to protect the national interest against problems that might arise from investment.

Also, we have decided to establish a new office to consolidate information on investment flows, and in particular cases to examine the prospective impact of proposed investments. Under these arrangements, we can expect to benefit from continued substantial flows of investments into the United States—again, if we can run a strong and inflation-free economy.

One view that I am sure has come to the attention of the subcommittee asserts that a substantial volume of foreign investments in dollars is, in effect, held involuntarily.

According to this view there is a massive "overhang" of some $100–$200 billion of foreign official holdings of dollars, placing constant downward pressure on the dollar.

This use of the term "overhang" is incorrect and misleading in present circumstances. I believe there was a genuine overhang several years ago, in the sense that some foreign countries had acquired dollars in excess of amounts they really wished to hold.

This is no longer the case. Dollars acquired by foreign official agencies, and invested here and in the Eurodollar markets, are acquired by choice, without the pressures arising out of a concern to preserve the monetary system.

The United States and the other countries are taking important steps to strengthen the international monetary structure at a time when there might be severe pressure that could otherwise disrupt exchange markets.

The technical details of a draft agreement establishing the $25 billion Financial Support Agreement in the OECD have just been completed. I plan to join with other OECD Ministers in signing the agreement in Paris on April 9, and we expect to propose legislation authorizing U.S. participation shortly thereafter.

This new supplementary facility will be an important element of our efforts to develop a cooperative response on the part of the major countries to the world energy situation; and it will also provide an important financial insurance mechanism to backstop cooperative economic and international monetary policies.

Signature of this agreement will bear witness to the importance that all OECD governments attach to this historic step toward financial solidarity.

POSSIBLE CHANGES IN RULES ON THE INTERNATIONAL MONETARY SYSTEM

The IMF will, of course, continue to play the central role in meeting the world's official multilateral financing needs. The broad outlines of a major increase in IMF quotas, which would enhance its capacity to perform this role, have been tentatively agreed upon.

The increase will be approved by the Interim Committee in June for submission to legislatures, if final agreement can be reached on the distribution of the new quotas and on a series of amendments to the IMF Articles of Agreement being developed in conjunction with our quota review.

I do not believe it would make sense to try to introduce abruptly a new, highly structured reform of the monetary system. That was essentially the judgment of the Committee of Twenty last June, and that judgment remains valid today. But the Committee of Twenty did envisage a number of important amendments of the IMF Articles to set the stage for a more evolutionary process of reform as circumstances warrant, and to help preserve the IMF's authority in dealing with current monetary problems.

The IMF executive directors are working intensively to reach technical agreement on amendments designed to eliminate certain rigidities and anachronisms in the system, for consideration by the IMF's Interim Committee at its June meeting. Three of these amendments—dealing with floating exchange rates, gold, and the use of IMF currency resources—are especially important.

The United States strongly supports an amendment to bring floating exchange rates within the legal framework of the IMF Articles. We are not comfortable with a situation in which we and all other countries—despite agreement that floating is the only desirable and practical course—are in technical violation of the articles because our currencies are floating. And continuation of this situation would tend to erode the Fund's authority as a "keeper of the rules."

As we have discussed in the past, Mr. Chairman, we need rules that would not require specific Fund approval for countries to refrain from attempts to maintain their exchange rates within narrow margins around par values.

The basic exchange rate obligations of member countries are to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations.

But countries should be free to meet these obligations in ways of their own choosing, so long as they adhere to internationally agreed standards of conduct.

I must report that the U.S. concept is not shared by many of the IMF members. A number of countries are prepared to retain the present rules, recognizing that all of the Fund's membership is presently in violation of these rules and will be in violation for the foreseeable future. Some are willing to provide a basis for floating in the Fund's legal framework but would constrain countries' ability to float more tightly than would the United States.

We shall continue to press for provisions that do not require specific IMF approval for a country which does not choose to maintain a par value.

I remain hopeful that the differences on this question can be resolved satisfactorily.

We have made more progress toward a convergence of views on gold. It is agreed that the monetary role of gold should be reduced. It is also agreed that the concept of an official international monetary price for gold should be abolished and that obligations on members to use gold in transactions with the IMF, as well as obligations on the IMF to accept gold from members, should be eliminated.

And it is agreed that the various restrictions that distinguish gold from other commodities and give it special status should be eliminated, subject to special transitional arrangements designed to insure that gold's role in the system is, in fact, reduced.

The key remaining questions are what these traditional arrangements should be and what disposal should be made of the fund's own gold holdings. We think it is important to have arrangements that would effectively prevent the reemergence of a de facto official or officially managed gold price, and which would sharply limit official purchases during a transitional period.

We also believe the Fund should be enabled to dispose of its gold in an orderly fashion and possible arrangements to accomplish this are under discussion. We will continue to work on these questions in the months ahead, and I will keep this committee and the Congress advised of our progress.

Finally, we are seeking amendments that would assure that all countries' currency subscriptions to the IMF are usable by the Fund under uniformly applicable rules, conditions, and criteria.

This is not the case at present, in that countries may effectively block the use of their currencies by the Fund, even though they may be in a strong payments position. We feel that such changes are essential to the rationale and justification for a quota increase, we will make the Fund a more truly cooperative institution, and will enhance its lending capacity.

This point is generally accepted in principle and I am hopeful that agreement on technical details can be reached shortly.

If these questions, and that of the distribution of the new quotas, can be settled in the coming weeks, the interim committee will be able to reach agreement in June on a comprehensive package of quotas and amendments. If that tentative schedule can be met, we would expect to be submitting the necessary legislative proposals to the Congress later this year.

Mr. Chairman, this statement has covered a lot of ground. Let me conclude by emphasizing the following points:

First, the value of the dollar against the generality of major world currencies is today very close to its value in 1973, just after the widespread move to floating rates. The dollar has been among the most stable of major currencies.

Second, financial officials in almost every country agree that it would be undesirable to try to peg exchange rates today, but that they will cooperate to maintain orderly conditions.

Lastly, in our efforts to maintain the dollar's value we will concentrate on strengthening our domestic economy through responsible monetary and fiscal policies at home. Let us always remember that the one fundamental condition for a sound dollar is a strong, inflation-proof U.S. economy.

Mr. Chairman, Jack Bennett and Chuck Cooper and I will be glad to respond to any questions that you may have.

Chairman REUSS. Thank you for that excellent statement, Mr. Secretary.

[The tables and chart attached to Secretary Simon's statement follow:]

TABLE 1.—TRADE-WEIGHTED EXCHANGE RATE CHANGES FOR SELECTED CURRENCIES DURING THE PERIOD OF WIDESPREAD FLOATING—MARCH 1973-MARCH 1975 [1]

[Percent changes relative to rates prevailing at end of February 1973]

As of end of month or date shown	United States dollar	German mark	United Kingdom pound	Japanese yen	Swiss franc	French franc	Italian lira	Canadian dollar
July 6, 1973 [2]	−4.4	13.3	−3.4	−0.8	2.5	3.6	−14.4	−1.8
September 1973	−2.6	11.7	−7.2	−.3	−3.2	−.6	−17.4	−1.8
January 24, 1974 [3]	5.1	8.4	−6.8	−9.2	−.5	−8.0	−12.0	2.2
March 1974	−1.1	12.2	−4.7	−2.5	−2.8	−7.7	−12.4	2.1
September 1974	2.2	8.6	−5.2	−9.1	6.9	−4.6	−16.9	1.8
Mar. 19, 1975	−2.2	13.4	−9.2	−8.6	15.7	−1.7	−22.2	−1.1

[1] Trade-weighted average appreciation (+) or depreciation (−) of each currency vis-a-vis all other OECD currencies.
[2] Low point for dollar during period.
[3] High point for dollar during period.

Source: Department of the Treasury

TABLE 2.—*Maximum variation in trade-weighted exchange rate indexes during period of widespread floating* [1]

Trade weighted index for:	*Percentage variation*
Italian lira	27.1
Swiss franc	24.4
New Zealand dollar	18.7
French franc	17.9
Australian dollar	17.7
Spanish peseta	16.4
Japanese yen	16.3
Pound sterling	13.3
German mark	12.6
Austrian schilling	12.6
Netherlands guilder	10.6
Norwegian krone	10.5
U.S. dollar	10.0
Swedish krona	7.5
Belgian franc	6.9
Danish krone	6.7
Canadian dollar	5.6

[1] Measured as the percentage by which the highest trade-weighted value of each of the listed currencies vis-a-vis all other OECD currencies exceeded the lowest trade-weighted value for that currency during the period Feb. 28, 1973–Mar. 19, 1975. Values are relative to base rates as of Feb. 28, 1973. Data are for the end of each month prior to Apr. 18, 1974, and both weekly and end-of-month thereafter.

Source: Department of the Treasury.

TABLE 3.—DIFFERENCES BETWEEN SHORT-TERM INTEREST RATES IN SELECTED FOREIGN FINANCIAL MARKETS AND THE UNITED STATES

[End of period; percent per annum]

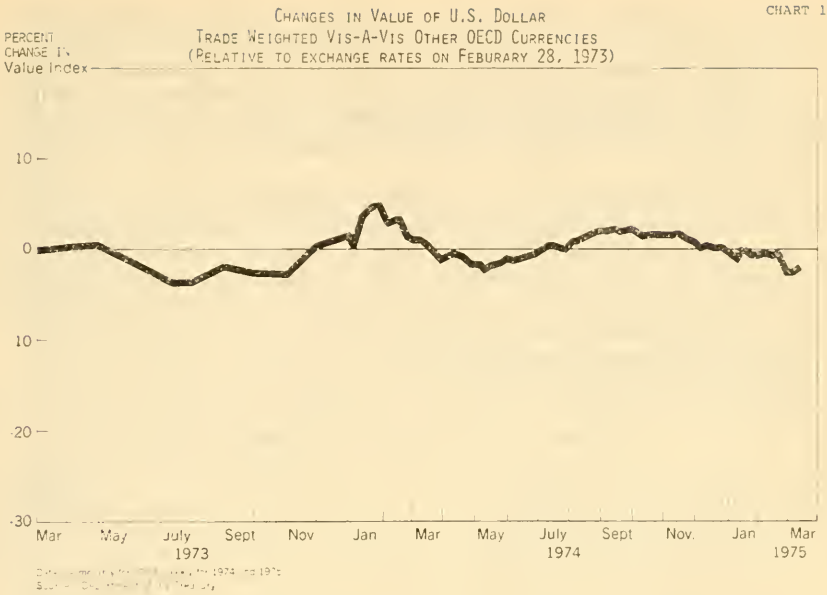
	September 1974	January 1975	March 1975	Latest date
Germany	−1.47	0.50	−0.25	Mar. 17
France	2.21	3.30	3.50	Do.
Switzerland	−4.17	[1] −.45	[1] 1.25	Mar. 7
Japan	1.83	5.55	7.25	Mar. 8
Canada	.21	−.45	.75	Mar. 17
Italy	6.58	6.68	6.50	Do.
Belgium	.83	2.55	2.75	Mar. 4
Netherlands	−3.79	−.89	.81	Feb. 28
United Kingdom	.83	4.67	5.19	Mar. 11
United States (actual rates)	11.17	7.45	5.75	Mar. 19

NOTES

Positive numbers indicate foreign interest rate higher than U.S. interest rate.

Short-term rates: United Kingdom—90-day local authority deposits; Germany—3-mo interbank loan rate; France—call money rate against private paper; Italy—3-mo interbank rate; Belgium—rate on 4-mo Treasury bills at mid-month; Switzerland—3-mo deposit rate; Japan—call money rate, unconditional; Canada—Canadian finance company paper; United States—60–89-day prime bank CD rate.

[1] Switzerland imposed a negative interest rate of 40 percent on foreign deposits.



Chairman REUSS. I think the committee and the Secretary are in complete agreement. If we want the international dollar to be safe and strong, the best thing we can do is get our own economic house in order here at home and move toward the goal of full employment without inflation as the 1946 act commands us.

Let me talk a little bit about intervention. You state very cogently, I think, that trying to intervene in the foreign exchange market to change the general value of the dollar, because somebody thinks it is too high or too low, is not a good idea. The only excuse for intervention by this country ought to be whether there are so-called disorderly markets, that is to say, markets so fragile that either no sales are being made or that the only sales being made are at widely disparate prices.

Isn't that a fair statement?

Secretary SIMON. That is correct, Mr. Chairman.

Chairman REUSS. You state that since last September total market intervention by the United States has amounted to slightly more than $1 billion. Is that $1 billion a net or a gross figure?

Secretary SIMON. That is a net number, Mr. Chairman.

Chairman REUSS. In other words then somebody could have sold $100 billion and bought back $99 billion and that would come out at $1 billion?

Secretary SIMON. Right.

Chairman REUSS. Well, that is very interesting. Can you now tell me how much was sold since last September and how much has been bought?

Secretary SIMON. It is within a few million of the same number, Mr. Chairman. If it were unwound today, if you will, the cost at the present market would be approximately $10 million but with the dollar strengthening presently and with our outlook as stated in my statement obviously this could be taken care of.

Chairman REUSS. Could you file at this point in the record when you correct your testimony the exact amount of sales and purchases?

Secretary SIMON. Certainly. As you know, we have never made public the intervention figures except with a timelag, but we do communicate with a subcommittee of the Congress in executive session 30 days after monthend with the exact intervention. We will be glad to give you this, sir.

Chairman REUSS. Thank you. The reason I ask is that at sometimes in the past some foreign central banks have in their intervention, so to speak, churned the portfolio, sold like mad in the morning, and bought like mad in the afternoon with no visible purpose other than to be busy. Therefore, the net figure you gave us will be greatly supplemented by that other information.

Secretary SIMON. Certainly.

[The following information was subsequently supplied for the record:]

U.S. Intervention, October 1974–February 1975

	Millions of dollars
U.S. purchases of foreign currencies	$190
U.S. sales of foreign currencies	1,305
Net U.S. sales of foreign currencies	1,115

Chairman REUSS. Starting with the $1 billion net, the great part of this occurred in the last few weeks, since February 1, did it not?

Secretary SIMON. The bulk of it has been since January of this year, yes, sir.

Chairman REUSS. By the bulk of it, my arithmetic indicates that this is $700 or $800 million of the $1 billion.

Secretary SIMON. I was going to say three-quarters, Mr. Chairman, yes.

Chairman REUSS. Well, was this a period marked by disorderly markets? The month of February in which all of this, most of it was done, seems to have been quite flat as far as the dollar was concerned.

Why all the excitement?

Secretary SIMON. It was disorderly on occasion, and several statements were made that threatened to make the markets even more disorderly—as per my statement, the indexing to the SDR which was misunderstood in many quarters, and the misinterpretation of our balance-of-payment figures; and the intervention was deemed wise at this time, in consultation with the Federal Reserve and with other nations.

Chairman REUSS. You have stated the official policy of the United States with regard to intervention; namely, we do not intervene—irrespective of what others may do—except when there are disorderly markets.

Who was responsible for implementing that policy?

Secretary SIMON. Well, we——

Chairman REUSS. The President? The State Department? The Treasury? The Federal Reserve?

Secretary SIMON. It is joint consultation with the Treasury Department and the Federal Reserve.

Chairman REUSS. Those two?

Secretary SIMON. Yes, sir.

Chairman REUSS. Who does the actual buying and selling?

The Fed, does it not?

Secretary SIMON. Yes, the Federal Reserve Bank of New York.

Chairman REUSS. In each case this has the approval of the Treasury?

Secretary SIMON. Yes, sir.

Chairman REUSS. How is that approval manifest? In what sort of document?

Secretary SIMON. Not in the form of a letter. It is always done in a meeting.

Chairman REUSS. Well, who keeps the minutes of the meeting?

Secretary SIMON. I don't believe official minutes are kept, Mr. Chairman. But I can assure you that if the thrust of your question is that intervention was done without the Treasury's approval, that is not the case. Decisions to intervene in the market are always unanimous.

Chairman REUSS. Billions of dollars are involved and there is a possibility, as you yourself have so well testified, that wrongheaded intervention can do great harm. Just as the open market committee keeps records of domestic policy, wouldn't it be a good idea if exchange market interventions were reported so that Congress, after the event, could take a look and assure itself that the matter had been thoughtfully considered.

Secretary SIMON. The Fed keeps an accurate record, of course, of hour-by-hour intervention. I see no harm in us keeping a memorandum of discussion, which is what you are suggesting, on why we made the decisions we did, and what the conclusions were in our consultations with the Federal Reserve.

Chairman REUSS. You either intervene or you don't, and intervention is a positive act. It must be agreed to by someone, and if I were dealing with billions of dollars, I would certainly want a little crumpled up piece of paper somewhere to——

Secretary SIMON. As I say, I would see no harm in that.

Chairman REUSS. Could we then have some sort of informal minute keeping so that we know that it was authorized and the reason for the decision?

Secretary SIMON. The development of the rationale behind our thinking; surely.

Chairman REUSS. That will be most satisfactory.

In a statement made to this committee on February 7, the Federal Reserve Chairman, Arthur Burns, said "The Federal Reserve and other central banks can, and occasionally do, intervene to smooth out movements in exchange rates."

Now smoothing out movements is another phenomenon than preventing disorderly markets.

Secretary SIMON. Isn't that funny? I would interpret Arthur's remark there as the same—smoothing out the markets where we have had unusual or uncalled-for moves in an exchange rate of a particular currency. That is what I would take the remark to mean.

Chairman REUSS. Does the Treasury, in giving permission for a given intervention, make an independent judgment as to whether disorderliness is in the air?

Secretary SIMON. We certainly do. We are in constant touch. Jack Bennett, my Undersecretary for Monetary Affairs, keeps a very close watch on this sector and we do indeed arrive at judgments independently. Who precipitates the phone call to the Fed, or whether we call them or they call us, varies from time to time.

We attempt, however, Mr. Chairman, always to act rather than react, and we attempt to be anticipatory, because sometimes, as you well know, if market movements are allowed to go too far, the intervention would have to be larger than if you could nip it in the bud, if you will. At other times it would be uncalled for—contradictory to the underlying market forces. This is what you and I would strongly object to—the pegging of a rate—which we absolutely would not do.

Chairman REUSS. Well, I certainly agree that pegging a rate is an error. I would also agree that fixing a zone or band is an error.

Secretary SIMON. So do we.

Chairman REUSS. I don't think that covers the firmament because between those two things and disorderly markets is a middle area. Some official, though he isn't pegging, though he isn't holding to a zone, may nevertheless feel that the dollar is too high or too low and want to improve matters, so he intervenes.

Secretary SIMON. There always has to be——

Chairman REUSS. He is a man to be watched, too, isn't he?

Secretary SIMON. Well, yes, the person who would be, as you suggest, perhaps thinking the way down deep or perhaps not even down deep that pegging the dollar at a particular rate or zone would be desirable. We resist that notion, as I have said.

We will only agree to intervention in the market when indeed there are disorderly conditions developing in the marketplace.

Chairman REUSS. If the U.S. authorities move to raise the international value of the dollar, they think it is too low, they think it is losing prestige, this could have some unfortunate consequences, could it not?

For example, just to be very practical, in Detroit today there are a great number of unsold compact motorcars. Detroit would like to sell those and it is largely a matter of price.

If somebody pursues the wrong kind of intervention and raises the value of the dollar, that makes Volkswagen or Fiat compacts from Italy or Germany that much cheaper in the United States. It would perhaps unwittingly put someone out of a job in Detroit, would it not?

Secretary SIMON. Well, that could be the effect. Again, the motion of setting artificial exchange rates based on the collective wisdom or individual wisdom of a so-called market expert is a wrongheaded idea.

Chairman REUSS. As further proof of its wrongheadedness, could not such action also lose a job for a worker in Chicago who makes machinery that his company wants to sell in export markets?

Secretary SIMON. Yes.

Chairman REUSS. Do you think that American prestige, again absent disorderly conditions, is really at stake just because the dollar at some point gets lower than somebody somewhere himself would like to see it?

Secretary SIMON. You know, we talk about American prestige and we worry about it and we continue to focus as I have so often said,

here in Washington on attacking the results of the problem rather than the causes of it.

Sure, if the dollar continues to decline and is deemed to be an unsafe currency by other countries what we ought to do is look at the reasons why and not attempt to artificially peg a dollar rate in contradiction to the market, which is the only true force that can set a rate that people are willing to own and hold dollars at.

That problem, as I outlined several times in my statement, is inflation. If we run a sound, balanced, fiscal and monetary policy in this country and have a relatively inflation-proof economy, we are going to return to a very strong dollar.

Chairman REUSS. Thank you. I appreciate your answers.

Congressman Hamilton?

Representative HAMILTON. Thank you, Mr. Secretary, I want to raise a question or two about the international energy program. As I understand it we have reached a tentative agreement on an IEP and part of that agreement relates to the situation that would prevail in the event of an emergency.

We have recently had a major setback in our Mideast policy over the past weekend and it raised in the minds of everyone I am sure the possibility of a crunch of some kind developing once again on oil supplies.

Under that emergency arrangement that has been worked out one provision relates to the allocation of available oil. By available oil is meant domestic oil or oil that will continue to be imported into a country. The shortfall is then spread among parties to the agreement.

I would like to ask you just what this means so far as the United States is concerned. We have a much larger percentage of our oil produced domestically than most of the nations that are party to this agreement.

What does it mean so far as sharing our domestic supplies and the oil imported from other countries that might not participate in any kind of a restrictive action against us?

Secretary SIMON. Well, it involves allocation of all the available supplies, domestic and international, but only after each country has put in effective conservation programs and actually cut their total consumption.

Representative HAMILTON. Does that mean the agreement on allocating available oil is not in effect at the present time?

Secretary SIMON. It would allocate to the countries that have been embargoed.

Representative HAMILTON. What does this mean for the United States?

Suppose you do have an embargo? Does this mean we will have to share some of our domestic oil with other countries, and if so, how much are we going to have to share with them?

Secretary SIMON. It all depends. Take the worst case situation, an OPEC embargo of the entire world, which you can give your own probabilities. In that case, the United States would have to share. The best case from a world supply viewpoint would be an embargo aimed directly at the United States, where we would be getting additional oil from other countries.

There is a range of possibilities in between those two. If there were other countries embargoed along with the United States, as the Nether-

lands was the last time, then there would be other countries sharing. But the best case and the worst case are those two.

Representative HAMILTON. What if you had a repetition of the event that occurred last winter?

Secretary SIMON. We would be gainers, Congressman Hamilton.

Representative HAMILTON. I didn't hear you.

Secretary SIMON. We would be gainers because the rest of the world was not embargoed.

Representative HAMILTON. Do I understand that in that situation we would not have to allocate any of our oil to other countries, Mr. Secretary?

Secretary SIMON. We would be recipients.

Representative HAMILTON. I see.

Well then, we would have to share then only in what circumstance?

Secretary SIMON. We share if there is a virtual cutoff of the entire world of OPEC oil. At that point it triggers conservation in every country, of course, the storage treatment, that will take years to get necessary storage in a country, and the formula goes into effect on how it would be allocated worldwide in that highly unusual circumstance.

Representative HAMILTON. Do I understand that this agreement is now in place and operative?

Secretary SIMON. Yes, sir.

Representative HAMILTON. Is that a correct understanding?

Secretary SIMON. Yes, sir.

Representative HAMILTON. I would also like to ask about the so-called $25 billion solidarity fund which I think is sometimes referred to as the Simon-Kissinger fund, with regard to recycling.

Are there any safeguards in that solidarity fund to assure future repayment by debtor countries; if so, what are they?

Secretary SIMON. It is a program based on guaranties by these governments. As far as the decisions to make loans, the main decisions will require a two-thirds weighted majority plus a simple unweighted majority of the countries voting and I think that, plus the guarantees, is safeguard enough.

And borrowers also have to follow sound economic policies—that is the purpose of this safety net, "last resort" facility. It was a major step toward integrating economic and energy and financial policies. So they have to follow sound economic policies at home to be judged by the financial ministers who will be voting on loans on the basis of those policies as well as the appropriate energy policies.

Representative HAMILTON. Now what kind of liability does the United States have in this situation?

Suppose you have a number of defaults for example?

Secretary SIMON. The risk is shared by all members, Congressman Hamilton. Our quota is 27.8 percent of the total.

Representative HAMILTON. Meaning we would pick up 27.8 percent of any debtor liability that would occur?

Secretary SIMON. That is correct.

Representative HAMILTON. What is our contribution to the fund?

Secretary SIMON. Our contribution to this fund would be 27.8 percent of approximately $25 billion, but this contribution would only be made on call. It would not be given in advance of need.

Representative HAMILTON. What is the status of that before the Congress? Are you seeking any money for it in the fiscal 1976 budget?

Secretary SIMON. I will be going over on April 9 to sign this agreement subject to the acceptance of Congress and we have been in active consultation with you and will continue to be on the various proposals and the legislation that is required.

There will be absolutely no obviation of the congressional process, Congressman Hamilton.

Representative HAMILTON. Let me direct you also to a provision in the Trade Act of 1974 which authorizes the President to consider how access to supplies of raw materials can be guaranteed. The act requires the President to enter into discussions with regard to our access to raw materials.

Can you bring us up to date on what, if anything, has happened pursuant to that provision of the Trade Act?

Secretary SIMON. The discussions have just started. Nothing substantive or definitive has happened.

Representative HAMILTON. What do you mean "just happened," in the administration or in Geneva?

Secretary SIMON. In Geneva.

Representative HAMILTON. What form did the discussion take?

Secretary SIMON. Through GATT.

Representative HAMILTON. So discussions are going on with GATT nations with regard to our access to raw materials that we are short of.

Secretary SIMON. It is part of the overall discussions and will be part of the multilateral trade negotiations that are commencing as well—the access to supply, potential threats of cartels in many of these internationally traded raw materials.

Representative HAMILTON. Do you have suggestions to make as to the timeframe under which we might expect some kind of multilateral understandings to develop with respect to our access to raw materials?

Secretary SIMON. I honestly think it is impossible to say it will be a year or 6 months. It is a very complex negotiation involving many different aspects and reluctance to agree in certain areas and absence of agreement in other areas. That is why it is impossible to put a timeframe on it, Congressman Hamilton.

Representative HAMILTON. We have seen articles in recent days with respect to OPEC countries abandoning the dollar and cutting their ties to the dollar. They have decided within recent months not to peg their own money to the dollar but to the special drawing rights.

I suppose it is possible within time that they will no longer price their oil in terms of dollars which, as I understand, they do today.

How do you read these developments in the OPEC countries and how serious do you think it is and is it a setback if they are doing that?

Secretary SIMON. We don't think it is serious. They did this for domestic purposes as far as their imports are concerned and you have to remember that the basket of countries that make up the SDR, the U.S. dollar is the most heavily weighted, 33 percent.

Representative HAMILTON. So you don't view that trend with any alarm at all?

Secretary SIMON. No, sir. That is right. I don't. Again, I would say that the basic source of strength of the dollar is a strong U.S. economy,

and I feel compelled to continue to emphasize the point that we need not worry about the strength of our dollar when we maintain sound economic policies here in the United States.

Representative HAMILTON. I didn't hear all your statement, Mr. Secretary, before I came in and you may have covered this, but to what do you primarily attribute the recent decline of the dollar exchange rate?

Secretary SIMON. I think primarily a reduction of our interest rates in advance of other countries. Our short-term interest rates have declined. Our 3-month Treasury bill rate—which is the barometer that I have always used—has declined from close to 10 percent in August down to about 5½ percent now. Of course this always has an effect on the flows.

Representative HAMILTON. Mr. Bernstein, a few days ago, attributed that decline in large measure to the large capital outflows from the United States last year.

Do you take a different position than that?

Secretary SIMON. Last year there were really inflows, not outflows. I am not sure I understand that position.

Representative HAMILTON. There was a capital inflow last year.

Secretary SIMON. Well, I commented in my statement on our balance of payments and on the report last week of a $10.6 billion balance-of-payments deficit on current and long-term capital transactions. But the way these figures are calculated in our Government excludes most of the investments in the United States—approximately $11 billion as best we can measure it—that came into the United States from OPEC countries.

Inclusion of these investments in the balance would have put us in balance and perhaps even into surplus, if we could trace all the investments—which I suggest is impossible. Also the declining dollar was the result of some fears about our domestic economy—and let me assure you that in my frequent meetings and meetings with finance people around the world, it is clear our domestic policies today as they threaten our future are raising serious questions in the minds of my associates all over the world.

I look forward to going to Europe in 2 weeks, and I will be meeting with my Finance Minister counterparts. But they are somewhat concerned as I obviously have been somewhat concerned—and that is putting it mildly—with our domestic policies as far as their inflationary impact next year and the year after.

We continue to look at the short term here in the United States and not develop the sound policies that are going to assure a strong U.S. economy in the future. We disregard the fact that we lived for a decade with excessive fiscal and monetary policies and work on the foolish assumption that we cannot pay any price that there will be no penalty for these sins.

Well, I suggest that is a wrong-headed notion.

Representative HAMILTON. Thank you, Mr. Chairman.

Chairman REUSS. I know, Mr. Secretary, you have another date up on Capitol Hill so I am just going to ask you one short question before we turn to Mr. Bennett and Mr. Cooper, and you may go your way.

In your statement you give your gratifying reassurance once again to this subcommittee that it is the U.S. position that any amendments

to the articles of the IMF should make clear that there is no stigma attached to a country that wants to use the system of flexible exchange rates such as we now have.

And that a country's decision to use flexible exchange rates should not be made dependent upon special permission granted by the other nations of the Fund. We are in accord on that view. My only concern is that you also indicate, as you have to, that there are others that take a different view.

I would emphasize once again that I hope you make clear to your negotiating partners that we in the Congress feel very strongly about this. We would not feel good about ratifying amendments to the articles which compel the United States to live a fib, so to speak, by continuing to operate as we are now doing in violation of the technical wording of the IMF charter.

Secretary SIMON. Yes, that is right.

Chairman REUSS. Since I believe our views are identical, I don't see any problem in your making it clear that Congress must ratify any amendments to the IMF articles. Therefore, since we don't object to our friends adopting fixed exchange rates if they think that is what is best for them, they should not object to our adopting flexible exchange rates if that is what we think is best for us.

Secretary SIMON. Mr. Chairman, let me assure you that I have, and I will continue to impress this fact upon my counterparts in the interim committee. We were very flexible in the most recent meetings, at least I was told we were, where we made some concessions primarily in the area of quotas. Our agreement to these concessions is based on agreement on floating rates, on the whole package, let's not just take one particular item out.

We feel very strongly about this, Mr. Chairman, as I know you do.

Chairman REUSS. Sounds good. Thank you for coming, Mr. Secretary, and if you would now excuse yourself we will ask Mr. Bennett and Mr. Cooper to stay around.

Let me start with Mr. Bennett and perhaps the $25 billion safety net figure that Congressman Hamilton was inquiring about. As has been made clear the U.S. exposure in that $25 billion safety net would be some 27.8 percent of the total.

Now many of our negotiating partners were quite willing that the entire safety net facility be handled under the International Monetary Fund, where there is already in place $6 billion safety net.

And in the IMF our exposure is only on the order of 22 precent. My question is, why don't we go along with the big infusion into the IMF, where the Arab countries are members? They would then have to take some part of the risk too. We would thus avoid burdening the taxpayers with that extra 5 percentage points of exposure.

Mr. BENNETT. As you know, Mr. Chairman, the solidarity fund is supplemental to use of the IMF. So we are planning to make primary use of IMF. The IMF will set up the so-called oil facility for this year up to $5 billion SDR's.

To date the IMF has only been able to raise somewhat less than half of that. I am sure they will raise more. It is not entirely clear that they would have been able to raise more than the $5 billion, although that was the original proposal.

I think it may be misleading to contrast the U.S. 22 percent in the IMF to the 27.8 percent in the solidarity fund. In the IMF, a large

number of the quotas are effectively not usable so that our share of the usable resources in the IMF is probably a larger percentage than our 27.8 percent in the solidarity fund.

But the primary reason for not wishing to handle this effort in the IMF was that it was considered to be a temporary effort, an effort of a very large potential scale as befits emergency insurance, one that was closely tied to a package of cooperation in the whole field of energy.

Chairman REUSS. Well, I would have to confess I am a little bothered by the fact that countries like Saudi Arabia and Kuwait and others that are awash with reserves, oil earnings, are not putting a dime in the $25 billion safety net, whereas, they play their part in the IMF.

Mr. BENNETT. Where we hope they will play an increasing part in the IMF in two senses. We hope they will take a larger quota share as befits their current economic position.

We hope they will agree as they should that their quota subscriptions should be fully usable. In some important cases, practically speaking, the funds are not usable.

We anticipate that in fact they will continue to make diversified investments of a nature that will make it unnecessary to call upon the solidarity fund. Only in the event that such diversified investments don't take place will the solidarity fund come into operation.

Chairman REUSS. Wouldn't the solidarity fund be even more solid if the Kuwaits and Saudis and others were in on it?

Mr. BENNETT. Well, I wonder. The solidarity fund comes into operation only if these countries don't invest. So it does not support the basic concept that it depends on those whose failure to invest would be the only opportunity for it to come into operation.

Chairman REUSS. I would have thought you could have no better incentive to invest on the part of Kuwait and the Saudis than the sure knowledge that if they don't measure up and invest satisfactorily, that they will be hooked on the $25 billion safety net. What would be more likely to make them lackadaisical about investment than the knowledge that if they don't invest, it will be not they, but largely Uncle Sam and the Federal Republic of Germany that have to bail out the member countries.

How would you respond to that?

Mr. BENNETT. Well, I think they are making investments in the places and in the securities they think are in their best interests.

I don't think they are making their investment decisions basically for eleemosynary reasons. They decide on a particular investment because they think it is best for them. I think they will continue to do that. I don't think they would have wished to join in this solidarity fund without some form of guarantee which we would not have proposed to give.

It seems to undermine the purpose of this operation to make it dependent upon those whose lack of cooperation would be the only occasion for it to come into operation. We want the consumer countries to have the confidence to undertake cooperative policies in the energy field regardless of what the OPEC countries do. This was the basic rationale.

Chairman REUSS. Did we try to get the OPEC countries to share the burden of the $25 billion?

Mr. BENNETT. There is a current effort underway to get them to share in financing the oil facility in the IMF. As I indicated, considerably less than the limit of 5 billion SDR has been arranged so far. We have not asked them to participate directly in the solidarity fund.

Chairman REUSS. Why not?

Mr. BENNETT. It seems contrary to the purpose of the fund. The purpose of the fund, Mr. Chairman, has been——

Chairman REUSS. What was the purpose of the fund?

Mr. BENNETT. That it would go into operation in case of emergency only.

Chairman REUSS. Mr. Cooper, can you elaborate on that a little bit?

Mr. BENNETT. Just a moment, sir. Even in the IMF oil facility these countries are basically not taking the risk. They are being guaranteed by the IMF members—Germany and the United States and other countries—that their investments in the oil facility will be repaid.

So even there, they are having a guarantee. Maybe Chuck Cooper would like to comment—I might have mentioned that Chuck has spent many days and hours in recent weeks negotiating the details of the solidarity agreement in Paris. I would be happy to have him comment.

Chairman REUSS. Mr. Cooper, why didn't anybody think to ask the Saudis, Kuwaits, and others if they would not like to share our burden in the $25 billion safety net?

Mr. COOPER. It was not an oversight that people just didn't think of asking them. It was a conscious decision that it was inappropriate.

Chairman REUSS. What was the rationale for that decision?

Mr. COOPER. They were being asked to provide financing through the IMF oil facility, which would be a more appropriate channel for their contribution. The basic rationale for the solidarity fund itself was to deal with the uncertainty that could arise because of investment action of OPEC countries, and to share the risk among cooperating countries.

It does not seem that trying to negotiate a risk-sharing operation with countries whose pattern of investment is causing the risk is likely to be successful or desirable. And the reason why the European countries and Japan and the other members of the OECD are strongly supportive of the solidarity fund is that we see a situation of great uncertainty. Basically, we remain confident about the ability of the existing arrangements to handle the flows, but there is uncertainty.

We recognize that the dimensions of the financial flows are far larger than has been traditional. We are not quite sure, none of us, how these flows are going to be managed in private markets, the IMF, or other arrangements.

It is not clear which individual countries may get themselves into the kind of difficulties that require some support from other OECD nations. I don't think that in present circumstances we would want to rule out government loans. Certainly there have been occasions in the past where government-to-government loans have been appropriate.

The question is how these might be arranged most equitably and efficiently, and that is really what the solidarity agreement does. There is nothing in it that would preclude countries from seeking loans from OPEC nations. They are free to do so, in fact they are encouraged to do that before they turn to the solidarity agreement.

But if that financing cannot be arranged the question is, what then stands behind the system? A system of financial insurance is what we have in the solidarity fund.

We are not trying to build government-to-government loans into the normal financial system. It is clear that they would only be used in exceptional cases and it is clear that the fund is a supplement to normal means of financing, not simply extending the normal means of financing which includes the IMF and so forth.

Mr. BENNETT. Mr. Chairman, I would like to mention one thing: This financial solidarity agreement is the financial counterpart of the energy-sharing agreement which the Secretary discussed with Congressman Hamilton.

Maybe it would be easier to comprehend that it would not have been appropriate to ask the OPEC countries to share in the energy agreement.

The same reasoning seems to apply to the financial agreement. Both are emergency agreements.

Chairman REUSS. Well, I just have to confess that I can't quite grasp the logic of our saying to Saudi Arabia and Kuwait and other OPEC countries, you got the world into this mess, therefore we are going to exclude you from participating in it until we get the world out of the mess.

But maybe I can get that concept sorted out by the time we take up the legislation.

Congressman Hamilton.

Representative HAMILTON. Thank you, Mr. Chairman. I just wanted to get some factual information with regard to the Secretary's statement. He said that a very high proportion of the investments by oil exporters remain denominated in dollars.

Do you have that figure handy as to what that proportion is?

Mr. BENNETT. We don't have precise numbers for this year, of course. For last year we do have estimates that out of their roughly $60 billion of new investments, $11 billion were placed directly here in the United States.

Representative HAMILTON. $11 out of $60 billion?

Mr. BENNETT. $11 out of $60 billion were invested directly in the United States. In addition to those investments in the United States, which were in dollars, a large portion of their investments elsewhere also was placed in obligations denominated in dollars. I would say roughly three-quarters of their total investments were denominated in dollars.

Representative HAMILTON. But roughly one-sixth of the——

Mr. BENNETT. A little over 18 percent of their investments were directly in the United States. It so happens that a little over 16 percent of their gross revenues from oil sales also came from sales to the United States. So both are in the same range, 18 and a fraction percent of their investments were here, 16 and a fraction percent of their sales revenue came from here. But a much larger percentage was denominated in dollars.

Representative HAMILTON. Was most of that investment in the United States in short-term securities?

Mr. BENNETT. Our $5 billion was in U.S. Treasury bills and almost $4 billion in short-term bank deposits and money market paper. About $1 billion was invested in long-term Treasury and Federal agency securities, and something around half a billion in equities and real estate.

Representative HAMILTON. I note the Secretary's statement that the administration has no intention of imposing capital controls. I presume you are monitoring the situation very carefully and reviewing it?

Mr. BENNETT. Yes.

Representative HAMILTON. But your position as of today is that there are no further investment controls of any kind that are needed in the economy?

Mr. BENNETT. Yes, sir, that is right.

Representative HAMILTON. Isn't there some problem with regard to investments in the banking system, where the foreign banks have certain advantages over domestic banks when it comes to branch banking?

Mr. BENNETT. Some of the States—this is a State choice—have allowed foreign banks to have branches in its State even though they have a branch in another State.

This is a choice they have made. They could do the same for American banks.

Representative HAMILTON. You don't see any problem with that or any necessity for changing our rules with respect to investments in banking?

Mr. BENNETT. The Federal Reserve has proposed legislation. I believe, that the opening of new banks here by foreign banks should be subject to an approval process which would take into account whether to assure that U.S. institutions are treated equitably in the country that is exporting the investment here.

Representative HAMILTON. What is the status of that?

Mr. BENNETT. That was introduced in the last Congress. I believe the Federal Reserve has recommended that it be reintroduced into this Congress.

Representative HAMILTON. Is that an administration proposal?

Mr. BENNETT. I don't believe the administration has formally commented on it yet, but it will in the near future.

Representative HAMILTON. Thank you, Mr. Chairman.

Chairman REUSS. I would have some questions about the negotiations apparently being conducted by the executive branch which resulted in agreement last Thursday, March 20, by the members of the International Energy Agency on the maintenance of an oil price floor at sufficiently high levels to encourage domestic energy investments—the specific price to be negotiated.

By what justification is the executive branch going around the world making decisions on American energy resources without consulting Congress concerning price policy?

The Congress is now trying to laboriously work out a program of subsidies and tax incentives and other devices for oil, old and new, offshore and inshore, and coal and oil shale, and nuclear and thermal and everything else. Who are these people who are going around the world making these statutory decisions without bothering to go to the Congress?

Mr. BENNETT. I assure you that there——

Chairman REUSS. It has been happening.

I read it in the paper, but I can't find out who is doing it.

Mr. BENNETT. There have been no statutory decisions.

Chairman REUSS. The last I heard was in our hearings in which—last November, Assistant Secretary of State Enders dismissed the whole thing as a little speech he had given at Yale which was no longer operative and Secretary Simon dismissed the whole thing, and now we find that there has been an international agreement.

Who is doing all of this?

Mr. BENNETT. The U.S. representatives to the Governing Board of the International Energy Agency have been discussing the desirability of the concept of some protection for investors against downside risk.

Now, they have not committed the U.S. Government in the sense that the President has already said that at an appropriate time he will request congressional legislation.

We have sought to get agreement among the executive branches on the principle of providing this protection to insure that adequate investment is made to avoid undue dependence on insecure imported sources of energy.

There have been consultations. Many a trip to the Hill has been made by people from the State Department and the Treasury to discuss this subject. There has been no request for legislation at this time. There will be at an appropriate time if these discussions can be advanced to a more specific agreement at a later date.

A general agreement and agreement on the concept, however, was felt desirable before the preparatory meeting of some of the consuming countries and producing countries now scheduled for April 7.

Chairman REUSS. Would you think an across-the-board fixed price for oil and other forms of energy is the way to operate in this country?

Or should other methods, direct subsidies, for example, be considered as methods of getting adequate domestic investment without raising the entire price structure across the board?

Mr. BENNETT. I am sure there will be a package of measures, and I am sure you realize what is being discussed has not been a floor for the international price of oil but rather the level, possibly a floor, at which it is priced internally in the countries, insofar as it affects the return to investors and conservation and production domestically.

It is not a floor on the international price.

Chairman REUSS. Hasn't the American consumer been adequately fleeced by the OPEC countries on the price of oil? Does he need our own country participating in an agreement to establish floor prices across the board?

Mr. BENNETT. Well, of course, we have taken the basic decision that complete free trade in this item is not compatible with our security; that some cost to the consumer, perhaps, is necessary to offset the extreme risk to the consumer of overreliance on imported oil.

Now, that level, of course, would be substantially below any prices the consumer is now paying.

Chairman REUSS. Has anybody explored the use of devices other than high prices in order to get adequate energy production, such as specific subsidies which do not cause the entire price of energy to go

up and give huge windfall profits to those who do not need the price increase?

Mr. BENNETT. As you know, a wide range of measures has been and is being considered. We have import fees, we have Federal support for research and development, and we have a large number of other measures under consideration. But it was felt that this should also be included so that the U.S. industry is not put at a competitive disadvantage with respect to other countries. It would be unfortunate, for example, if our industry were paying a much higher cost for its energy than their direct competitors in other countries were.

Chairman REUSS. It certainly would, but to agree on a floor seems a rather odd way to proceed. A floor would simply insure that our consumer pays the higher price and that producers of cheaper forms of energy get huge windfall profits.

Mr. BENNETT. You can conceive of a circumstance, for example, in which the cost to the U.S. investor, consumer, or producing firm, were by some device made higher than the cost in other countries so that our consumers were then bearing an undue share of the risk. The purpose of the international agreement is to see that our consumers do not bear an undue proportion of the risk. Now there are, of course, alternative ways of doing this, but the purpose behind this whole approach is to insure a fair sharing of the burden.

Chairman REUSS. Can you give me the name of a single Senator or Congressman who has authorized the administration to enter into agreements to raise the price of oil in this country by international agreement?

Mr. BENNETT. My knowledge of the Constitution would suggest there is no Senator or Congressman who can authorize such a thing individually.

Chairman REUSS. Well, that is right, but you said earlier that——

Mr. BENNETT. There have been consultations.

Chairman REUSS. You stated you have been up on the Hill talking to people. Insofar as that talk has been on the record, the administration has been told to forget about it. We don't want to fleece the consumer any more than he already has been.

Mr. BENNETT. You say "anymore than"——

Chairman REUSS. We want rates to come down, not to be held up.

Mr. BENNETT. I fully agree with you, and the object of this, of course, is not to raise prices. It is to get the investment that will allow prices to be lowered and have security at the same time.

Chairman REUSS. But who in Congress, Senator or Congressman, has told the administration to go ahead and use a floor on oil prices, as opposed to subsidies or whatever else, as a method of getting adequate adjustment without allowing windfall profits to those segments of the industry that don't need it?

Mr. BENNETT. Well, the discussion in the Governing Board has covered a wide range of things including research and development assistance and the concept of a price floor. Maybe it would be of interest to you, and I can ask the State Department whether possibly they would give me a complete list of those Senators and Congressmen who have been visited to discuss the concept.

Chairman REUSS. Well, I would like not only a list but some indication of whether the State Department thinks that it has any congressional sympathy whatever for this proposal.

It seems to me the State Department is doing precisely what Secretary Simon said should not be done, just a few moments ago; namely, negotiating an international floor on the price of oil.

Mr. BENNETT. Well, I am sure you understand the difference between negotiating a price with oil producers—which is not what we were discussing—and negotiating among consumer countries concerning adequate incentives for investment within those countries, which is what we are discussing.

Chairman REUSS. But they are doing it by price. If they want to negotiate——

Mr. BENNETT. But it is not a price negotiated with the oil producers. It is negotiation among the consumers to assure that the effective price internally will be such-and-such.

Chairman REUSS. Yes, that seems to me ancillary because why should the consuming countries inflict this on themselves?

It is bad enough when the OPEC people hold us up. Let me just say that unless you are prepared to produce some Congressmen or Senators who have given the State Department the green light, I think that the administration is off on a frolic of its own and it is misleading other countries in entering into the tentative agreement which it apparently entered into last Thursday.

Congress is currently attempting to keep a two-price system on oil—for instance, it has a ceiling on old oil and different arrangements on new oil. Congress is contemplating the careful and well-calibrated use of subsidies to make available new forms of energy, oil shale, and solar and geothermal, and so on.

But I don't think Congress would appreciate at all some unauthorized person entering into purported agreements to set a floor under oil domestically in the States and thus guarantee forever windfall profits for the low-cost oil companies.

What can we do about that?

Mr. BENNETT. I think there should be a qualification. The proposal is that each country accomplish this with its own devices. It does not guarantee windfalls to anyone.

Chairman REUSS. Well, has the press misreported it? As I have read it, they have talked about a floor for the price of oil, I think the price was $7 or $8 as opposed to the $2 that it was selling for before the embargo.

Mr. BENNETT. I think there has been no agreement. No agreement has been attempted on the number.

Chairman REUSS. Not on the number, but wasn't there agreement in principle that there should be a numerical floor, with a specific number to be worked out later?

Mr. BENNETT. There is an agreement that the equivalent of that should be negotiated as a means of calling forth adequate investment.

Chairman REUSS. Have you got a copy of the agreement here?

Mr. BENNETT. No, I don't.

Chairman REUSS. Can you get it for us?

Mr. BENNETT. I think so.

Chairman REUSS. Would you file it with us? We would like to have it today if we could.

Mr. BENNETT. All right.

Chairman REUSS. You say that the agreement does not speak in terms of price, but merely says each country do what it thinks wise to generate more investment in energy, whether by subsidy, by tax incentives, by differential price, or whatever way will get the needed energy without giving windfall profits to the existing low-cost producers.

Is that what it says?

If it did, it would not bother me——

Mr. BENNETT. It is intended to allow the maximum flexibility for each government to choose the exact details on that. But the basic concept is that energy will not be imported into the domestic market at effective prices, translated into the return to the investor, whether he is investing in production or conservation equipment, at lower than some agreed level. So in that sense there is a floor. But I will try to get you a copy.

Chairman REUSS. If that is what it is, then it is just what I feared—namely, a self-imposed cartel to put a floor under prices. What we need is competition in different forms of energy. Those that are high cost where necessary can be grubstaked by government subsidies, tax incentives, or whatever is needed.

But the idea that you have to raise the whole price structure in order to bring in that last increment of supply—that wouldn't do you any good.

Mr. BENNETT. I resist the concept of "raising the whole price structure." I look at it as just the reverse. It is trying to assure the investor that if he invests, he does not have an extremely high risk, that the effective price, when his investments come to fruition, will be only $2 or $3.

Chairman REUSS. Here you have——

Mr. BENNETT. That brings up the question——

Chairman REUSS. Why not assure the investor in a particular form of energy a carefully rifle-shot subsidy rather than raise the whole price structure?

Mr. BENNETT. There will be some use of the rifle shot, but I think we also recognize the inability of us in government to be sure we know where the best place to invest is or where the most effective pulling forth of new energy will be.

I have some doubts about the wisdom of relying only on rifle shots rather than on the traditional American system of relying on the price mechanism.

Chairman REUSS. If you are saying it is a traditional American system for the Government to rig the price level and impose a floor by government cartel then you and I have been around different parts of America. I thought that was what the Sherman Act was written to prevent. But in any event, I don't want to prolong this. I do want to give you my firm view that our officials in Paris who are making the agreement, which you are going to send up later today, are operating without authority, that Congress will not go along with their——

[At this point the lights went out.]

Chairman REUSS. God heard us.

That Congress will not go along with the attempt to set an internationally agreed floor, and that Congress wants to consider that whole

spectrum of devices to get the necessary energy that we need in this country.

I particularly am put out about what is happening in Paris because this committee was assured by both the State Department and the Treasury Department last November that nothing as foolish as this was even contemplated, that it was just a pipedream that had been allowed to go away. Now we find it actively being pushed.

So I still say that the Secretary's statement was an excellent one and that on almost all the things we have discussed there is very great agreement between the Treasury and this committee.

But on the oil floor; no. I would have just a couple of questions on gold. Should central banks be permitted to buy gold in the private market?

Mr. BENNETT. I think we should have the objective of removing all constraints of trading in gold as we removed it on trading in other commodities. We felt that to be sure there was no misunderstanding of moves in that direction there should be a transitional period in which there should be some limitations on central banks buying of gold, but even today there are no limitations on their selling.

Chairman REUSS. Then your view is there should not be limits on the purchase by central banks of gold?

Mr. BENNETT. We think there should be some transitional limitations on their purchases so that there would be no possibility of increasing the total gold holdings held officially during a transition period.

Chairman REUSS. When central banks sell or buy gold between themselves, what price should those transactions be at?

Mr. BENNETT. There are no such transactions today.

Chairman REUSS. What if they should occur?

Mr. BENNETT. When they occur they should be at whatever price they can negotiate.

Chairman REUSS. If most central banks revalue their gold reserves, as the French have already done, and the private market price for gold then dropped below the level at which gold was valued in the official reserves, what would be our view about official support of the private gold market?

Mr. BENNETT. As far as I know, no government has revalued its gold since the French took that action. The French in revaluing theirs took the entire profit and put it aside in a reserve which, of course, they could use to offset any downward movement in the price of gold the next time they account for it, and our feeling is that governments should not—and there should be an understanding among governments—be able to peg the price at any level or within any zone.

Chairman REUSS. Thank you very much, Mr. Bennett and Mr. Cooper.

We appreciate your helpfulness. We now stand adjourned, subject to call of the Chair.

[Whereupon, at 11:10 a.m., the subcommittee adjourned, subject to call of the Chair.]

THE INTERNATIONAL MONETARY SITUATION AND THE ADMINISTRATION'S OIL FLOOR PRICE PROPOSAL

MONDAY, APRIL 28, 1975

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INTERNATIONAL ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room S-407, the Capitol Building, Hon. Henry S. Reuss (chairman of the subcommittee) presiding.

Present: Representatives Reuss, Moorhead, and Hamilton.

Also present: Sarah Jackson and John R. Karlik, professional staff members; and Michael J. Runde, administrative assistant.

OPENING STATEMENT OF CHAIRMAN REUSS

Chairman REUSS. Good morning. The Subcommittee on International Economics of the Joint Economic Committee will be in order for its hearing on the administration's oil floor price proposal. We will ask Mr. Lichtblau, Mr. King, Mr. Steele, and Mr. Branson to be seated.

On last February 3, Secretary of State Kissinger proposed that the major oil importing countries adopt a common floor price for oil imports—by means of a tariff, quota, or variable levy—to protect new energy sources from becoming noncompetitive if world oil prices dropped sharply. Since then the U.S. Government has hammered away in the International Energy Agency to gain its allies' support for the proposal. The Congress, however, has not yet considered the merits of the proposal, much less delegated authority to the Executive to negotiate commitments which have such direct impact on domestic energy policy. In fact, the Congress is presently endeavoring to work out a comprehensive policy for energy development and conservation. It is resisting administration requests for a price floor.

Today, we would like to examine the proposed mechanism for a minimum import price. Is it the most efficient way to stimulate investment in domestic production needed to attain the desired level of energy self-sufficiency? Who would be the beneficiaries of such an across-the-board guarantee, American consumers, energy-producing companies, or the OPEC cartel?

Even if import restrictions might be necessary to protect the domestic energy-producing industries in the event of a world oil price collapse, why is it necessary to negotiate a price floor internationally

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and lock ourselves into an agreement to maintain high prices? Could not arrangements be made at some subsequent time for mothballing high-cost investment, should lower prices prevail? Is the price floor proposal really intended to be the first half of a commodity agreement aimed at fixing long-term energy prices? Would this be in our interest?

This morning we have with us four distinguished witnesses from the academic world and the private business to discuss the merits of the administration's proposals. They are Mr. William Branson, professor of economics at the Woodrow Wilson School, Princeton; Mr. William King, director of corporate policy analysis of the Gulf Oil Corp. of Pittsburgh; Mr. John Lichtblau, executive director of the Petroleum Industry Research Foundation; and Mr. Henry Steele, professor of economics at the University of Houston.

Gentlemen, you have been very kind to help us this morning. We have your prepared statements and we would now like to ask you to proceed in your own way as you would give us the benefit of your thinking. We will make it alphabetical order, which makes you, Mr. Branson, as our leadoff witness.

STATEMENT OF WILLIAM BRANSON, PROFESSOR OF ECONOMICS, WOODROW WILSON SCHOOL, PRINCETON UNIVERSITY

Mr. BRANSON. Thank you, Mr. Chairman.

In thinking about these problems, I felt that it would be useful to think through the question of energy policy, starting with an attempt to consider essentially what the problem is that we are trying to deal with, then to go to the general objectives of policy, and finally to try to outline for myself the elements of a program that would meet those objectives. At the conclusion, since I notice that some of the things I have outlined were not things that were being proposed by the administration, I would like to note some objections to some of those things that were being proposed, which include the floor price for oil.

I have submitted an outline of these points, and I will talk through that, adding a few explanations as I go. The problem, as I see it, is that with the rise in price due to the formation of the cartel, the current international price of oil exceeds the cost of production. The cartel poses an implicit threat to cut prices, which potentially locks investment out of alternative sources of energy. That is, to a certain extent, a long run problem. The cartel can cut off the supply in the short run for political reasons. This is the boycott problem that we might want to deal with, and it is not clear to anyone how stable the cartel is or how long it will last, which introduces a large amount of uncertainty to the problem.

The objectives that I see in the energy policy are trying to minimize the real social cost of energy consumption, to reduce imports, to put pressure on the world market price, and to reduce our shortrun vulnerability to a boycott, and to do these things without locking resource allocation into a high oil price, since one of the objectives of the policy should be to try to bring that price down.

The elements of the program that seem to me to be essential can be boiled down to about five points. First, I think it is clear that we have to reduce imports. And I think the point that has been missed occa-

sionally in the public discussion is that we can reduce imports by increasing production, as well as by reducing consumption. There seems to me to be substantial overemphasis on reducing consumption of oil. The rise in the price that we have already seen will reduce consumption, and it strikes me as a curious argument that since the sellers have monopolized the market and doubled or tripled the price, therefore we will now put a tax on it to raise the price by another 50 percent or so to the U.S. consumer. It seems to me we could go at this from the production side more easily and less painfully by freeing up energy prices from domestic regulation.

The second clear policy point would be to encourage investment into alternative sources, and here the problem, as you know, is that there is a possibility of price cutting by the cartel, which makes investment very risky.

The floor price has been put forward as a way to deal with that. It seems to me that there are two ways that are better, depending on whether you want the investment to be done in the private or in the public sector. One way, in the private sector, would be a subsidy deficiency payments scheme which would be focused on the problem rather than putting a broad floor under prices, and would allow the price to consumers to be set at the world market price. If you want to do it in the public sector, I would imagine some kind of nationalized company, which developed new resources, would be possible. There would be substantial precedent for that.

The third point would be to free other energy prices to rise to meet the equivalent world oil price. This, I think, is a simple extension of the point about increasing production to reduce imports. I have seen some Federal Energy Administration calculations which seem to say that freeing the price in this way, and deregulating natural gas, would reduce imports by 1985 to a number like 2 million barrels a day from a number like 12 million in 1972. They seem to think that other supply actions, such as developing Naval Reserves and pushing ahead with offshore leasing, might add another 4 million barrels to output, which would switch the United States to being an exporter by their calculations.

I think that if there is a major concern about windfall profits in a scheme of letting the domestic prices rise to meet world prices, then something direct could be done about that. One thing that immediately comes to mind is a further reduction of the depletion allowance to offset the profits effect in the short run of that kind of deregulation.

A fourth point would be to stockpile energy to some number of months of consumption in order to reduce the credibility of a boycott threat. This would take some calculations about the costs and benefits of how many months, but I should think that it would be a feasible element of policy.

The fifth would be to put as much pressure as possible on the cartel by encouraging other consumers to reduce imports and to promote a credible emergency allocation scheme. It seems to me the different countries can reduce imports in different ways. There is no reason to think that all countries should use the same techniques. The United States can reduce imports by increasing production, and some European countries cannot. So, if they are going to reduce imports, they have to reduce consumption. There is no reason for us to do that

because that is the only feasible way for some of these European countries that do not have the North Sea resources.

I can turn now to the points that I list in my outline as things to avoid, which turn out to be parts of the administration's program. I had worked this through before I was familiar in any detail with the administration's program.

The first thing I would avoid is raising taxes or tariffs to cut energy consumption. The basic problem we are facing is that the oil market has been monopolized and prices have been increased three or four times. As I said before, I cannot see the logic of adding a tax-induced price increase on top of that.

If the objective of a tax increase is to reduce consumption, then it would seem to me that the oil tax that has been imposed by the cartel is already sufficient for that. If, before the oil price was increased, one was for putting a tax on the consumption of petroleum products for ecological or for conservation reasons, then it would seem that the fact that the price has already been increased so much would weaken that argument rather than strengthen it.

The second thing that I would avoid is getting locked into a floor price for world energy. It seems to me that that would preclude the possibility of a price drop for consumers if the cartel breaks or softens, and it would cause a substantial distortion of resource allocation as we put the price of a major import far above its price of production for reasons that are not at all clear to me. I think it would be much better to have a specific and narrow subsidy guarantee for domestic producers who are being encouraged to invest in the alternative sources of energy.

The third thing that I would not want to do is negotiate an agreement with the sellers about the price. It seems to me that would put the consumers in the position of keeping the cartel glued together, which should be a job that should be left to the people who are monopolizing supplies.

So, I think that all three of these points, which seem to be part of the administration's program, are attempts to get at a difficult problem, but attempts which are dominated by other possibilities; namely, freeing up domestic production, leaving the consumer price to be set by the world market so the consumers can get the benefit of a price drop, and leaving to the sellers of oil the job of keeping the cartel glued together, rather than adding the consumers efforts to that.

Thank you.

Chairman REUSS. Thank you, Mr. Branson.

[The prepared outline referred to in Mr. Branson's statement follows:]

PREPARED OUTLINE ON ENERGY POLICY OF WILLIAM BRANSON

I. PROBLEM

[Price has been raised by a cartel using price for political ends on occasion.]

1. Current international price exceeds cost of production of domestic oil and alternatives.
2. Cartel poses implicit threat to cut price, potentially blocking investment into alternatives.
3. Cartel can cut off supply in the short run for political reasons.
4. Not clear how stable cartel is, or how long it will last.

II. OBJECTIVES

1. Minimize real cost of energy consumption by developing domestic sources with cost of production less than international oil price.
2. Reduce imports to put pressure on cartel.
3. Reduce short-run vulnerability to boycott.
4. Do not lock resource allocation into high oil price, since cartel may bust, and it is our objective to bust it. This means any plan must be flexible enough to accommodate a substantial drop in international price.

III. ELEMENTS OF PROGRAM

1. Reduce imports by freeing domestic production. This will help in the short run.
   (*a*) Imports can be reduced by cutting consumption or increasing production.
   (*b*) Rise in price cuts consumption to optimum level as consumers react to price.
   (*c*) Free old oil price to rise to world market. Result: Substantial increase in domestic production, drop in imports.
2. Encourage investment into alternative sources.
   (*a*) Problem here is possibility of predatory competition from oil exporters.
   (*b*) To counter this, some guarantee has to be offered to producers.
   (*c*) Best idea of a bad lot—price guarantee as in agriculture. Set a price at which they'll get back investment, and pay a subsidy of that price less market.
3. Free other energy prices to rise to meet world oil market.
   (*a*) This is an extension of items 1 and 2, and would reduce dependence in short run and long run.
   (*b*) If a major concern is "windfall profits," cut further into depletion allowances to offset them.
4. Stockpile oil to a prescribed number of month's consumption against boycott possibility. Here detailed calculations are needed.
5. To maximize pressure on the cartel, encourage other consumers to reduce imports, and promote an emergency allocation scheme.
   (*a*) Each country will have a different way to reduce imports. U.S., Britain, Norway can expand output, some others can't, for example.
   (*b*) Consider expansion of output that would make U.S. an exporter, reducing European imports from OPEC. (Freeing old oil price could raise U.S. production to about total consumption level.)
   (*c*) U.S. should commit supplies to an emergency allocation scheme to keep Europeans in it.

IV. WHAT TO AVOID

1. Do not raise taxes to cut energy consumption.
   (*a*) The basic problem is that oil prices have been increased four-fold by the cartel, and other energy prices will follow.
   (*b*) No point in raising prices even more, unless *independent* environmental or conservation considerations dictate. But keep these separate.
2. Do not get locked into a floor price for world energy prices.
   (*a*) This would preclude possibility of a price drop if the cartel breaks up, and distort resource allocation to meet cartel's monopoly price.
   (*b*) It is better to have a narrow and specific subsidy or guarantee for domestic producers who invest in alternative sources.
3. Do not negotiate a consumer's agreement with OPEC. This would put the consumers in the job of keeping the cartel together and the price up even if the cartel would break up otherwise.

Chairman REUSS. We will hold our questions until we have heard from all of the panel. Mr. King, please proceed.

STATEMENT OF WILLIAM C. KING, DIRECTOR, CORPORATE POLICY ANALYSIS, GULF OIL CORP., ACCOMPANIED BY WILLIAM H. BLACKLEDGE, JR., EXECUTIVE VICE PRESIDENT, GULF OIL TRADING CO.

Mr. KING. Good morning, Mr. Chairman, and gentlemen.

We appreciate the opportunity to present to you the position of the Gulf Oil Corp. in regard to proposals for establishing a floor price for crude oil. I am William C. King, and I am accompanied by William H. Blackledge, Jr., executive vice president of the Gulf Oil Trading Co.

The purpose of the proposed floor price program is to provide continuing encouragement for the development of various forms of energy—which is becoming ever more costly. This proposal is supported on the basis that the OPEC nations, if they chose, could jeopardize or bankrupt projects for the development of synthetic fuels and new energy sources in consuming nations simply by making sudden and arbitrary reductions in the price of the oil which they export.

To analyze these proposals it is important to separate their application into two categories:

First, we must consider the relationship of a floor price to the international crude oil markets, and second, the need for financial support for synthetic fuels projects and the development of new energy sources.

Gulf does not support the establishment of any specific floor price for crude oil—either in international or domestic markets. We feel that such a pricing mechanism is impractical and would not be workable when needed.

I should say by floor price, I include any predetermined, fixed minimum price, so-called safeguard prices, or any mechanism for specifying a price at which tariffs or quotas would be initiated.

If the floor price is set only marginally lower than present prices, it will appreciably slow down the present trend toward softening of prices—a trend already noticeable for those crudes which have been posted at premium price levels relative to their quality and transportation advantages. A floor price at levels high enough to discourage such price erosion would be unacceptable to most, if not all, oil importing nations.

On the other hand, if the price floor is set dramatically lower than the present market level, it would be more acceptable to the importing nations, but would afford limited or inadequate support to energy development in those nations.

None of us has the wisdom to determine what price level would minimize these problems, and, as demand requirements and economic conditions change, such price levels will change periodically. As we know all too well, there are few regulations more inflexible than price controls.

Adequate protection can be obtained by providing the importing government with standby authority to impose tariffs on imported oil. This would provide the least cost to the importing country, for the funds represented by the tariff would accrue to its treasury—whereas any effective price support resulting from a price floor would accrue to the treasuries of the oil-exporting nations. As explained above, the standby authority should not include specified price levels at which

the tariffs would be imposed. These tariffs should be temporarily imposed and maintained no longer than needed.

Should such a tariff be utilized, it will be important to include tariff drawback provisions so that exports from the United States of finished goods would not be at a competitive disadvantage in foreign markets in which lower or no crude oil tariffs existed.

The President, of course, already has the authority to levy such tariffs, and drawback procedures have been used in this country for some time.

Gulf wishes to emphasize that establishing a temporary tariff, at the time it is needed, is the most it believes the Government should do. Price controls tend to come in pairs, and any price floor mechanism will create pressure for a price ceiling mechanism. Such price regulation, and particularly a ceiling, will do far more to retard domestic exploration and production than any threatened OPEC price reductions.

The most important and effective program for developing domestic energy production would be for the Federal Government to:

First, firmly establish that it fully supports the development of such a program by industry.

Second, see that adequate conditions will be provided to enable financing and profitable operation of efficient projects.

Third, provide that price controls will be phased out as quickly as possible. With the confidence provided by such Government support, the industry can undertake considerably greater risks than are possible at present.

Gulf believes that the danger of predatory OPEC pricing actions has been overemphasized. If the OPEC nations elect to drop their prices to discourage our oil production, they will be losing at least $3 for each $1 which the United States and the United Kingdom producers might lose. The actual multiplier, of course, will be much larger, for the price reductions would only impact on a portion of the production in the United States and the United Kingdom. It is obvious that this would be an unbearably expensive exercise for the exporting nations.

That this is so is highlighted by the recent report in the Oil & Gas Journal that Saudia Arabia may shortly announce a $150 billion, 5-year internal development program. This means that in addition to the present expenditures they would need an additional $30 billion annually to finance this program. At their present rate of oil exports, this represents about $10 per barrel. There is little doubt that the incentive and the political pressures within Saudia Arabia to initiate and carry out such a development program are quite high. The other large exporters—Iran, Venezuela, Nigeria, and Indonesia—are already spending internally the major portion of their oil revenues.

Now let me turn to the relationship between synthetic fuel projects and price floors. Again, the Gulf Oil Corp. does not support the use of price floors as a means of encouraging the development of synthetic fuel projects. Even with an energetic synthetic fuels development program, it will be a decade or more before the total output of synthetic fuels represents more than a few percent of our total oil and gas consumption. To prop up more than 95 percent of the market in order to

support less than 5 percent of the production is economically untenable.

This is not to say that such projects do not need a strong incentive system. They do, but these incentives should be provided on a project-by-project basis.

Shale oil, coal gasification, coal liquefication and related projects for the development of new energy sources all share similar problems and risks. These may be summarized briefly as follows:

1. TECHNICAL

In most cases this technology, while a reasonable extension of established technology, nevertheless has not been proven on a commercial basis and involves considerable uncertainties in regard to operability, yield efficiencies, metallurgy, et cetera.

2. ENVIRONMENTAL

These projects will in many cases involve extensive mining operations, waste disposal problems, and will require significant supplies of water.

3. ECONOMIC

There has been little experience in regard to actual investment or operating costs.

The combination of the above factors results in unusually high economic and technical risks. These risks, when coupled with the huge investments required for nominally sized commercial plants—in the range of $500 million to $1 billion per project—would result in a situation whereby such projects would not normally be undertaken until supply or alternative energy sources became so short as to result in rapidly increasing energy prices to the point where such prices would provide in themselves an attractive economic potential and one commensurate with the risks involved.

Because of the importance of energy to our entire economy, the long leadtimes in developing such projects, and the need to accommodate environmental concern to a high degree, it is in the national interest to initiate promptly a series of demonstration plants in shale oil and synthetic fuels. Such projects would involve full-scale equipment, but would be of limited capacity. For example, one full-scale reactor line would be used, rather than a number of such lines.

To provide for this early establishment of such projects, a program of Government financial support must be made available. It is important that this Government program apply to several projects in any given new energy field. A number of such projects is needed to provide for alternative design features, a variety of learning experiences, and at least a nominally competitive situation. It would be premature to establish an incentive program for commercial plants until results from the demonstration plants are available.

For the demonstration projects, an incentive program will have to include the following principles if it is to be effective:

First, the most basic problem is funding. Without adequate financing, any additional incentives would be totally ineffective. The pres-

ently established program in which the Federal Government provides all or the major portion of the financing for such demonstration projects should be continued. Under present conditions, private industry cannot commit the needed capital funds to such projects, which by their nature have no chance of providing a profitable operation.

Second, the project would be managed and operated by the industry company or group sponsoring it.

Third, there should be no commitments required of the Government or the company sponsor to proceed to the next state of development or commercialization, or to deliver specified volumes of synthetic fuels.

Fourth, the details of application of these principles should be negotiated on a project-by-project basis by the Government and the company sponsor. Each project will have a unique set of resource availability and quality, utility supplies, location and transportation factors, and environmental and social needs.

An effective incentive for synthetic fuels demonstration projects can be supplied by a program such as I have outlined, and will be much less costly than most other suggestions.

There will be some who object to any form of financial incentive to private industry. But it is important to note that the production from a single 100,000 barrels-per-day synthetic oil plant will displace $450 million of oil imports per year. In a little over 2 years this sum would be equivalent to that needed to finance the entire project, and this plant would be supporting jobs in the United States rather than abroad, and would stimulate our economy. This is ample reason for moving toward commercialization expeditiously as well as prudently.

It is of major importance from the standpoint of the Nation's energy capability that effective incentive programs be established to stimulate the installation of a number of demonstration plants in each of these synthetic energy fields. The basic criteria for these incentive programs must be to reduce the risk to the operator to acceptable levels. Unless this is done, these projects will not be carried out as soon as the public interest requires.

Thank you.

Chairman REUSS. Thank you very much, Mr. King.

[The prepared statement of Mr. King follows:]

PREPARED STATEMENT OF WILLIAM C. KING

PROPOSALS FOR ESTABLISHING INTERNATIONAL FLOOR PRICES FOR CRUDE OIL

Good morning, gentlemen. I appreciate the opportunity to present to you the position of the Gulf Oil Corporation in regard to proposals for establishing a floor price for crude oil. The purpose of such a program is to provide continuing encouragement for the development of various forms of energy—which is becoming ever more costly. It is also supported on the basis that the OPEC nations, if they chose, could jeopardize or bankrupt projects for the development of synthetic fuels and new energy sources in consuming nations simply by making sudden and arbitrary reductions in the price of the oil which they export.

To analyze these proposals it is important to separate their application into two categories:

First: The relationship of a floor price to the international crude oil markets, and

Second: The need for financial support for synthetic fuels projects and the development of new energy sources.

As you recognize, these are two very separate situations. They need to be considered separately in respect to the advantages or disadvantages of any floor price mechanism.

It has been suggested that a floor price for international crude oil markets would provide assurance to companies exploring for oil and gas in more costly areas, such as the deeper offshore areas, that their investments would not be endangered by future OPEC price reductions. These price reductions could result from the normal workings of supply and demand market factors, or from predatory price manipulation by the OPEC cartel. As I will explain, such manipulation is unlikely.

Gulf does not support the establishment of any specific floor price for crude oil—either in international or domestic markets. We feel that such a pricing mechanism is impractical, and would not be workable when needed.

If the floor price is set only marginally lower than present prices, it will appreciably slow down the present trend toward softening of prices—a trend already noticeable for those crudes which have been posted at premium price levels relative to their quality and transportation advantages. A floor price at levels high enough to discourage such price erosion would be unacceptable to most or all oil importing nations.

If the price floor is set dramatically lower than the present market level, it would be more acceptable to the importing nations, but would afford limited or inadequate support to energy development in those nations.

Should market prices approach such a dramatically lower floor price level, the economic pressures necessary to bring about such a major change would make it highly unlikely that the market level would stop at the price floor. Should importing nations impose a tariff in this case, exporting nations would undoubtedly move to increase prices to offset the tariff. Even if only partially successful, such a move would increase costs to the importing nation. In this situation, political realities in those nations predominantly dependent on imports for their energy supply would make it difficult or impossible to maintain the price floor mechanism.

None of us has the wisdom to determine what price level would minimize these problems, and, as demand requirements and economic conditions change, such price levels will change periodically. As we know all too well, there are few regulations more inflexible than price controls.

In regard to areas such as the North Sea, it is important to recognize that although the cost of such oil to the consumer in the United Kingdom will be relatively high, the economic cost to the United Kingdom could be much lower than the cost of foreign crude. This is due to the fact that much of the cost of the crude oil produced in the North Sea will result from the utilization of facilities built in the United Kingdom and installed with local labor. Further, the cost of operating labor is not a net drain to the economy. The stimulus of this industry to that economy is a very decided asset and one that is worth a significant delivered oil price differential.

Such a differential can be protected by providing the importing government with *standby* authority to impose tariffs on imported oil. This would provide the least cost to the importing country, for the funds represented by the tariff would accrue to its treasury—whereas any effective price support resulting from a price floor would accrue to the treasuries of the oil exporting nations. As explained above, the standby authority should not include specified price levels at which the tariffs would be imposed. These tariffs should be temporarily imposed and maintained no longer than needed.

Should such a tariff be utilized, it will be important to include tariff drawback provisions so that exports from the United States of finished goods would not be at a competitive disadvantage in foreign markets in which lower or no crude oil tariffs existed.

The President, of course, already has the authority to levy such tariffs, and drawback procedures have been used in this country for some time.

Critics of this proposal observe that it would tend to discourage the exporting nations in making price deductions. There may be some merit in this observation, but a price floor or a specified price at which tariffs would be levied would be more effective in discouraging price reductions.

Since an importing government can speedily invoke import tariffs should they be needed, it is best not to establish such tariffs, even on a provisional basis, until they are needed. It is impossible to foresee the details specific to any future oil import situation and any application of such a tariff should be tailored to each specific situation.

Gulf wishes to emphasize that establishing a temporary tariff, at the time it is needed, is the most it believes the government should do. Price controls tend to

come in pairs, and any price floor mechanism will create pressure for a price ceiling mechanism. Such price regulation, and particularly a ceiling, will do far more to retard domestic exploration and production than any threatened OPEC price reductions

The most important and effective program for developing domestic energy production would be for the federal government to:

Firmly establish that it fully supports the development of such a program by industry;

See that adequate conditions will be provided to enable financing and profitable operation of efficient projects; and

Provide that price controls will be phased out as quickly as possible.

With the confidence provided by such government support, the industry can undertake considerably greater risks than are possible at present.

Gulf believes that the danger of predatory OPEC pricing actions has been overemphasized. Oil production in the U.S. and in the North Sea are the only two areas against which such a procedure might be directed. Consumer nation production in other areas is too small to warrant this kind of attention on the part of the exporting nations. In the case of the North Sea and the United States, the total oil production involved would be in the range of ten million barrels per day, or roughly one-third of the total oil that OPEC sells abroad. Thus if the OPEC nations elect to drop their prices to discourage our oil production, they will be losing at least $3 for each $1 which the United States and the United Kingdom producers might lose. The actual multiplier, of course, will be much larger, for the price reductions would only impact on a portion of the production in the United States and the United Kingdom. It is obvious that this would be an unbearably expensive exercise for the exporting nations.

That this is so is highlighted by the recent report in the Oil & Gas Journal that Saudi Arabia may shortly announce a $150 million five-year internal development program. This means that in addition to the present expenditures they would need an additional $30 billion annually to finance this program. At their present rate of oil exports this represents almost $10 per barrel. There is little doubt that the incentive and the political pressures within Saudia Arabia to initiate and carry out such a development program are quite high. The other large exporters—Iran, Venezuela, Nigeria and Indonesia—are already spending internally the major portion of their oil revenues.

Now let me turn to the relationship between synthetic fuel projects and price floors. Again, the Gulf Oil Corporation does not support the use of price floors as a means of encouraging the development of synthetic fuels projects. Even with an energetic synthetic fuels development program, it will be a decade or more before the total output of synthetic fuels represents more than a few percent of our total oil and gas consumption. To prop up more than 95% of the market in order to support less than 5% of the production is economically untenable.

This is not to say that such projects do not need a strong incentive system. They do, but these incentives should be provided on a project-by-project basis.

Shale oil, coal gasification, coal liquefaction and related projects for the development of new energy sources all share similar problems and risks. These may be summarized briefly as follows:

1. *Technical.*—In most cases this technology, while a reasonable extension of established technology, nevertheless has not been proven on a commercial basis and involves considerable uncertainties in regard to operability, yield efficiencies, metallurgy, etc.

2. *Environmental.*—These projects will in many cases involve extensive mining operations, waste disposal problems, and will require significant supplies of water.

3. *Economic.*—There has been little experience in regard to actual investment or operating costs.

The combination of the above factors results in unusually high economic and technical risks. These risks, when coupled with the huge investments required for nominally sized commercial plants (in the range of $500 million to $1 billion per project) would result in a situation whereby such projects would not normally be undertaken until supply or alternate energy sources became so short as to result in rapidly increasing energy prices to the point where such prices would provide in themselves an attractive economic potential and one commensurate with the risks involved.

Because of the importance of energy to our entire economy, the long lead times in developing such projects, and the need to accommodate environmental

concern to a high degree, it is in the national interest to initiate promptly a series of demonstration plants in shale oil and synthetic fuels. Such projects would involve full-scale equipment, but would be of limited capacity. For example, one full-scale reactor line would be used, rather than a number of such lines.

To provide for this early establishment of such projects, a program of government financial support must be made available. It is important that this government program apply to several projects in any given new energy field. A number of such projects is needed to provide for alternative design features, a variety of learning experiences, and at least a nominally competitive situation.

The information developed from these projects should be available by license from the operator to parties interested in developing commercial projects. Full-scale commercial projects should depend primarily on normal commercial factors and be built by private industry at a time when they can be supported by the market price structure. It would be premature to establish an incentive program for commercial plants until results from the demonstration plants are available.

For the demonstration projects, an incentive program will have to include the following principles if it is to be effective:

(1) The most basic problem is funding. Without adequate financing, any additional incentives would be totally ineffective. The presently established program in which the federal government provides all or the major portion of the financing for such demonstration projects should be continued. Under present conditions, private industry cannot commit the needed capital funds to such projects, which by their nature have no chance of providing a profitable operation.

(2) The project would be managed and operated by the industry company or group sponsoring it.

(3) There should be no commitments required of the government or the company sponsor to proceed to the next stage of development or commercialization, or to deliver specified volumes of synthetic fuels.

The details of application of these principles should be negotiated on a project-by-project basis by the government and the company sponsor. Each project will have a unique set of resource availability and quality, utility supplies, location and transportation factors, and environmental and social needs.

An effective incentive for synthetic fuels demonstration projects can be supplied by a program such as I have outlined.

There will be some who will object to any form of financial incentive to private industry. But it is important to note that the production from a single 100,000 B/D synthetic oil plant will displace $450 million of oil imports per year. In a little over two years this sum would be equivalent to that needed to finance the entire project, and this plant would be supporting jobs in the U.S. rather than abroad, and would stimulate our economy. This is ample reason for moving toward commercialization expeditiously as well as prudently.

In considering financial incentives for synthetic fuels projects, it is important to recognize that shale oil falls in a different category than does coal gasification, coal liquefaction, or solvent coal refining. A shale oil project, of itself, will make a net contribution to the nation's energy supply. Perhaps more importantly shale oil represents a long-term source of liquid hydrocarbons required for applications where no substitutes are available. These applications include fields such as petrochemicals, jet airplane fuel, and lubricants. It is interesting to note that these fields typically support a relatively large number of production and service jobs per barrel of input. Thus from a standpoint of security of long-term supply, demonstration of commercial feasibility of shale oil production should have a high national priority.

In the case of coal gasification, coal liquefaction, or solvent coal refining, the production of coal provides a net contribution to our energy supply, but the synthetic fuels plants for converting coal to gas and oil produce less energy in the form of the synthetic fuel than is charged to the plants as feedstock and fuel.

However, this energy shrinkage in the conversion step may be more than offset by related advantages. All of these synthetic fuels, as is shale oil, are environmentally attractive to the user. They have essentially no sulfur, are clean-burning, and will provide minimal or no particulate emissions. They will not require stack gas scrubbers.

In addition, synthetic gas and oil will be transported to a significant extent in existing distribution networks—particularly via pipeline. This efficient mode of

transportation will appreciably offset the energy used in the production of these fuels.

This is particularly important in the case of natural gas, where the fixed charges related to pipeline investment represent a major portion of the delivered cost of the gas. Should natural gas supplies dwindle in the future, reduced throughput in these transmission lines will result in increasing delivered costs simply because the large fixed cost must be spread over fewer and fewer delivered units of gas. By maintaining with synthetic gas a higher volume of delivery in existing pipelines, these price increases will be moderated.

Thus it is of major importance from the standpoint of the nation's energy capability that effective incentive programs be established to stimulate the installation of a number of demonstration plants in each of these synthetic energy fields. The basic criteria for these incentive programs must be to reduce the risk to the operator to acceptable levels. Unless this is done, these projects will not be carried out as soon as the public interest requires.

This concludes my testimony. I will be glad to answer any questions you may have.

Chairman REUSS. Please, proceed, Mr. Lichtblau.

STATEMENT OF JOHN H. LICHTBLAU, EXECUTIVE DIRECTOR, PETROLEUM INDUSTRY RESEARCH FOUNDATION, INC.

Mr. LICHTBLAU. Thank you, Mr. Chairman, for inviting me to participate in today's hearing on the subject of the proposed floor price for imported oil.

The floor price concept cannot be discussed separately from title IX of the administration's omnibus energy bill, the Energy Independence Act of 1975 (H.R. 2650). Apparently, the administration is seeking passage of title IX for specific legal authority to establish a floor price.

Title IX, whose full name is the Energy Development Security Act of 1975, would authorize the President to impose import restrictions, such as tariffs, quotas, fees, or other measures, to set minimum domestic petroleum price levels following an official determination by the FEA Administrator that a price reduction in imported oil threatened the viability of U.S. petroleum production and development and/or threatened to cause a substantial increase in U.S. petroleum demand.[1]

The difference between the floor price, which has been subject to a good deal of public discussion, and title IX, to which very little attention has been paid, is that the former is an attempt to devise on specific solution now to a hypothetical future problem while the latter is a general standby authority to do something if and when the hypothetical situation arises.

Actually, the President already has the legal authority he is seeking under title IX. The national security clause in our foreign trade legislation has been used since 1959 to control the level of oil imports, first through quotas and since 1973 through a system of fees. Thus, if passed, title IX would be primarily in the nature of a policy declaration, making clear that even a substantial reduction in foreign oil prices will not deter the United States from pursuing its established goal of reducing reliance on foreign oil sources.

The floor price proposal, by contrast, calls for specific action. While no official floor price for imported oil has been proposed, Secretary

[1] See FEA, Draft Environmental Impact Statement on Energy Independence Act of 1975, March 1975.

Kissinger in his speech of February 3 said that it "would be considerably below the world oil price," while the FEA in its impact statement on title IX assumes a $7 per barrel, and Assistant Secretary of State Thomas Enders is reported to have tentatively suggested a floor price of $6 to $8 per barrel. It would therefore seem that some policymakers have not only adopted the floor price as a preferable method of import control to quotas, auctions of import licenses, or other means but have already decided on the approximate level of the price.

Yet, there are several serious problems with the selection of a floor price, both in principle and in the determination of a specific level at this time.

One, in trying to devise specific counterstrategies now to a possible future break in foreign oil prices we are dealing with a series of unknowns. For instance, it would make a basic difference whether the price break came as a result of market pressures or as a result of an OPEC strategy to undercut the development of relatively high-cost alternate energy sources. In the first case, if it came as a result of market pressure, the price decline would be of the consuming countries' own making and would be beneficial to them; in the second case, it would be directed against them. It is difficult to see how the two cases could call for the same response.

Two. A price decline could take many forms, not all of which could be offset through the mechanism of a floor price. For instance, if prices remained unchanged but credit terms were extended or deferred payments were accepted, a floor price would become ineffectual while a quantitative import restriction could work.

Three. The floor price could also turn into a ceiling price or, at least, U.S. oil producers might fear such a development and act accordingly. Once the administration has determined what it considers to be a precise level required to maximize domestic crude oil production and maintain desired restraints on demand, the politically loaded question of why a higher domestic price level should be permitted is bound to be raised. Since for the foreseeable future the floor price is likely to be set well below work market prices which, in turn, determine free domestic oil prices, domestic producers might be reluctant to undertake new oil projects that require a higher price than the established floor price for fear that the floor price might become the legal ceiling price. Thus, some of the incentives created by OPEC to develop oil or other energy supplies outside of OPEC may actually be counteracted by the imposition of a floor price.

The possibility that the floor price would coincide with the true optimum domestic oil price is not more than random, given the many unknowns and unknowables that determine such a price.

Four. According to the FEA's environmental impact statement, the floor price is not expected to have any impact on actual development and operation of synthetic fuels and other relatively undeveloped energy sources. Yet, it is by no means clear that a price floor on imported oil is required to assure continued production and exploration for conventional domestic crude oil. Certainly, the oil companies have not requested it. Most seem to be willing and eager to incur the risk of new exploration ventures, provided no restrictions are placed on them.

No company needed a floor price to find and develop Alaskan oil and virtually the entire oil industry is now urging the Government to open up the Atlantic and Pacific Outer Continental Shelf areas for exploration even though the cost is expected to be very high by historic U.S. exploration standards.

Similarly, there is no evidence that any oil company is afraid to make the capital investments for secondary or tertiary recovery systems at present free market prices for fear of a futue drop in import prices. The only thing that keeps some companies from maximizing enhanced recovery methods is not fear of an OPEC price drop by inability to obtain OPEC level prices now for the recovered oil because of existing Federal price ceilings on "old" oil.

In other words, those for whose benefit the floor price is designed do not require it or want it, while those who may need some sort of price guarantee or other form of minimum profit protection—the developers of synthetic oil or other new energy sources—would not benefit from it and are not intended to.

This is not to suggest that the floor price should be raised so as to encompass the later group. Ten years from now, less than half a million barrels per day of synthetic oil, about 2 percent of our total oil requirements, will be produced. It would make little sense to raise the price of the other 98 percent—I think Mr. King had 95 percent, but it is 10 years from now, of our oil to the level required to bring forth synthetic oil. Rather, a special price protection or other form of profit protection should be extended to producers of synthetic fuels to get this industry off the ground and into the commercial stage.

In addition to the foregoing considerations which are primarily domestic, the establishment of an oil floor price at this time would also cause a number of international problems. The proponents of the floor price within the administration have argued that the price must be accepted by all major importing countries, otherwise an international oil price break could leave the United States with a higher and therefore less competitive energy cost structure than its trading partners. The United States has therefore urged adoption of the floor price by all members of the newly formed International Energy Agency.

However, a drop in foreign oil prices would have a very minor short-term effect on U.S. domestic oil and other energy output, almost regardless of the size of the drop. The reason is that actual operating costs of most energy producing facilities represent only a small part of total costs because of the capital intensity of energy production. Thus, even shale oil at a required price of $12.50 per barrel has an operating cost of only $4.77 per barrel "at the outside," according to a recent testimony before a congressional committee.[1]

Any oil or other energy-producing operation whose operating cost is below import costs could therefore be expected to meet a drop in import prices for some time. This would give the United States time to adjust to the new situation, if it ever arose, appraise its meaning and then take the necessary action, if possible collectively, otherwise unilaterally.

Until or unless that price break really occurs, it will be difficult to get a true agreement within the IEA on a specific floor price. The

[1] Statement by Charles H. Brown, senior vice president, the Oil Shale Corp., before the House Committee on Sciences and Astronautics, Dec. 17, 1974.

agreement in principle that has recently been announced is mostly designed to patch up cracks in the organization which could prevent it from devoting itself to its principal and best suited task, the preparation of an international emergency oil-sharing system. Those IEA members who are also domestic oil and gas producers, such as the United States, Canada, Great Britain, and Norway, have much in common with the nonoil producing members on this last point; that is, the sharing system, but very little on the concept of minimum import prices to protect high-cost domestic production.

In conclusion, I would say that there is justification for title IX—the granting of a standby authority to the President to prevent a lowering of foreign oil prices from undermining our long-term energy policy. However, the selection of a specific mechanism and a specific price within this mechanism now to cope with this hypothetical problem is likely to be counterproductive.

Guarding against the calamity of a world oil price drop does not exactly require priority treatment. After all, just 15 months ago we were told it was the increase in world oil prices that threatened to destroy the world's economies.

Thank you.

Chairman REUSS. Thank you, Mr. Lichtblau.

Mr. Steele, please proceed.

STATEMENT OF HENRY STEELE, PROFESSOR OF ECONOMICS, UNIVERSITY OF HOUSTON

Mr. STEELE. I wish to express my appreciation to the subcommittee for inviting me to present this statement this morning, and it is my hope that it may be of some use to you in your deliberations regarding the critical issues of future petroleum supply.

In this summary, I shall attempt to provide brief answers to certain of the question listed in the April 23 press release which announced this hearing.

Is the floor price the most efficient way to encourage domestic production needed to attain the desired level of energy self-sufficiency? If so, at what level should the floor price be set to protect energy investments in conventional and synthetic fuels against a future international price decline?

I do not believe a floor price would be the most efficient device for achieving such a purpose. There are several objections to such a plan.

First, the provision of an explicit price floor bolsters the monopoly power or the exporter cartel, by reducing the motivation of exporters to even consider offering price concessions. As I stated in my appearance before this subcommittee last year, the most important task of the importing countries is to form an importer cartel for the purpose of forcing down buying prices—and not to create obstacles to such declines.

Second, the proposed scheme is probably not feasible. The different importing countries can scarcely be expected to agree upon a common price floor—unless the price floor is so low as to be meaningless—since their interest in high versus low energy prices differs according to their prospects for becoming producers as well as consumers of energy resources. It would be logical for the United States and the countries

sharing in North Sea oil production to favor a relatively high floor price, while importers like Japan, with no prospects for indigenous fuels industries, would logically prefer no floor at all.

Third, alternative devices, such as direct subsidies to higher cost producers, appear to be more efficient.

But, if we assume that floor prices are instituted, in spite of the above objections, at which level should they be set? The level of the price floor depends primarily upon the degree of domestic self-sufficiency which is sought. If complete elimination of imports is sought, such a floor price would have to be unrealistically high, unless the goal is to be achieved only at the end of a very long period of time. Even a lesser degree of self-sufficiency would obviously require the production of liquid and gaseous fuels from other sources than crude petroleum, and the prices required to obtain substantial supplies of synthetic fuels are a matter of conjecture, but they would appear to be quite high. My own studies on the economics of synthetic fuels are now out of date, but my assessment of the most recent work of others suggests that costs of coal liquefaction are disappointingly high, at perhaps $12–$15 per barrel for first generation commercial scale plants. Although costs per barrel should decline over time as production experience accumulates, it is rather doubtful that such cost declines would greatly outpace expected rates of inflation, particularly as they affect the cost of facilities in capital-intensive industries.

Hence it is possible that a price floor of over $15 per barrel might be necessary to provide the desired degree of reliance upon domestic production—and even so, the supply additions would be forthcoming only over a period of many years. As for the price floor needed to induce substantial additional output from conventional petroleum reservoirs, this is also a matter of considerable uncertainty.

In 1973, I made studies of the longrun supply schedules for oil and gas for the period through the year 2000, for a variety of cases. The most optimistic case did not assume complete self-sufficiency, but merely that the United States would be capable of producing enough oil to keep reliance upon Eastern Hemisphere imports down to 10 percent of total consumption, and that the ratio of reserves to production would be no lower than 8 to 1 by 2000. The necessary price required to achieve this goal was about $7.50 in 1972 dollars. Inflation since 1972 would increase the price to about $9.50 in 1975 dollars, and the elimination of depletion would probably require a further increase to about $11 to compensate for higher per-barrel tax payments—although the latter computation is difficult to estimate because of the variety of possible responses of the petroleum industry to the removal of depletion.

Thus, $11 per barrel might be a very rough estimate of the supply price necessary to achieve one version of self-sufficiency from more intensive exploitation of petroleum resources, while $15 or more might be required to achieve a greater degree of import independence through the development of synthetic fuels. Such high floors can be expected to have little appeal to U.S. consumers, and still less for buyers in other importing countries.

What would be the effects of a floor price on the structure of the energy-producing industries both domestically and internationally? Would such a floor price facilitate investments by new companies

needed to maintain a healthy and competitive domestic industry or merely provide greater benefits to existing major companies?

In itself, a high floor price would naturally tend to increase investment in energy industries throughout the world, relative to a situation in which no such floor was provided. A very high floor guaranteed by all the consuming nations would eventually stimulate enough exploration and discovery to create considerable excess producing capacity even outside the export cartel, although this is likely to be a factor only in the very long run. If a high floor price is guaranteed by only one or a few importers, the worldwide effect on exploration and discovery will be correspondingly reduced.

The petroleum industry is definitely an industry of increasing marginal costs, such that higher prices are required to achieve higher rates of production. In general, the expectation of a high future price level would mean more intensive development of existing fields and more extensive exploration, particularly new and higher cost areas such as offshore and Arctic drilling. Riskier investments would be undertaken, and more would be invested in attempts to perfect methods for increasing recovery from known reservoirs.

The effect of a high floor price on future costs of energy production is hard to appraise. More money spent on research, particularly in successful research on methods to detect directly the presence of oil in underground formations, might eventually pay off in terms of greatly reduced costs of exploration, just as successful research in field development might decrease unit costs of production.

It is not prudent, however, to depend too heavily upon the possibility of such favorable outcomes. The basic fact is that higher prices will justify higher cost marginal operations, and thus at the margin of economic viability in any region, higher cost production will persist. A high-price floor will without doubt facilitate new entry into those phases of the industry requiring relatively moderate initial investment, such as onshore drilling in the more accessible locations. It is not to be expected, however, that price supports in themselves will greatly increase the relative share of oil and gas production controlled by the smaller operators.

Would a minimum price for oil imports affect future costs of domestic energy production by inflating the purchase price of oil leases?

In theory, if competitive bidding occurred for a mineral property known with absolute certainty to contain a definite volume of ore deposits, and if future prices and production costs were also known with certainty, then the "lease bonus" or other lump-sum cash payment for the right to exploit and deposit, would amount to the entirety of the excess of total revenue over total costs—including the costs the necessary competitive rate of return on investment—after discounting for the time pattern of future costs and revenues. Under such circumstances, any price increase without a corresponding cost increase will merely increase the lease bonus and leave everything else constant.

The presence of uncertainty, however, is the primary fact of minerals exploration, which cannot be overlooked. This uncertainty involves both the existence and extent of mineral resources in a given tract, and their probable cost of exploitation. A relatively high floor

price will shift the margin of new exploration outward from more familiar areas to less familiar areas. This means an increase in the degree of uncertainty associated with the typical new venture. Lease bonuses will be rather highly discounted for uncertainty, since a cash bonus paid in advance of drilling places all the risk of exploration failure on the bidder.

On the other hand, royalty bidding, which shares the risk of dry holes between operator and landowner, would not be affected quite so much by uncertainty. Hence the answer to this question appears to be that, while there is some tendency for oil lease prices to rise, this effect would not be a major factor since it tends to be obscured by allowances made to take account of uncertainty. It should also be noted that the elimination of percentage depletion will be an offsetting factor which will tend to reduce lease bonuses.

What are the principal alternatives to the oil floor price proposal? Would a well-targeted program of direct and contingent subsides be a less costly way of developing needed energy resources than maintaining a floor price for imports?

The institution of a price floor at levels necessary to provide this country with a substantial degree of import independence in the long run, would mean a price increase, which would raise the price of all petroleum purchased. At least for the time being, I would prefer to see domestic oil and gas prices freely determined by supply and demand.

The main advantage of a price floor is in investment planning. If a floor were to be set at a level below the current price for new oil, it would serve the useful purpose of providing companies with a minimum price guarantee for investment planning calculations. But if world prices declined, domestic prices would not be allowed to fall under the proposed price floor plan, and domestic buyers would pay higher prices than those who purchased elsewhere at the world price level.

The employment of this device would permit consumers to purchase at the lower world price, and the cost to the taxpayers would be direct subsidies which would differ among producers in accordance with the gap between their production costs—including profit allowance at a risk-adjusted competitive rate—and the market price. The total cost to consumers plus taxpayers would be less under a direct subsidy arrangement than the total cost to consumers under a price floor plan.

The obvious drawback to this type of direct subsidy plan is that it requires the determination of unit production costs for all producers whose costs drop below the reduced price. The problems of cost determination are particularly difficult in petroleum, although such difficulties as will arise need not prove insuperable. Similar subsidy arrangements for producers of certain metals were implemented during the Second World War.

Another feature of subsidies is that total consumption is generally greater under subsidies than under price supports. Whether this feature is an advantage or a disadvantage in the context of the petroleum market is considered in the answer to the next question.

Production of synthetic liquid fuels is a special case; here the required price would be too high to serve as a floor price, and some sort of subsidy arrangement would be necessary. A number of arrange-

ments are possible. The Government might build synthetics plants of its own, which it would lease to operators, as was done with much wartime industrial capacity expansion during 1942–45. The terms of the leases could achieve limitation of profits to competitive levels in a number of different ways. For example, production could be sold at the prevailing market price to buyers, and the seller would be reimbursed for the difference between this price and the seller's computed unit cost, by way of a subsidy payment per unit. If cost fell below price, a negative subsidy would be levied.

I will leave the answers to the other four questions to my fellow panelists.

Chairman REUSS. Thank you, Mr. Steele.

[The prepared statement of Mr. Steele follows:]

PREPARED STATEMENT OF HENRY STEELE

I wish to express my appreciation to the Committee for inviting me to present this statement this morning, and it is my hope that it may be of some use to you to your deliberations regarding the critical issues of future petroleum supply. I am an academic economist with major research interests in industrial organization and the regulation of industry, and in presenting this statement I represent no one but myself.

The basic problem is to devise a strategy which will permit this country to achieve a balance between petroleum supply and demand at a price which reflects the long run cost to our society of reliance upon the energy-consuming processes of industrial society. But what is this price? The upper limit of this price would be the cost of producing fuels from strategically secure sources of supply, where only domestic U.S. sources are defined as sufficiently secure. The lower limit would be long run marginal production cost in a perfectly competitive world market free from the problems associated with public or private monopoly on production or the use of force. In the period between the late 1950's and the late 1960's, world market prices were slowly tending toward the lower limit, and might have reached it except for that element of price which represented contributions to the rulers of the exporting regions. Today, under completely changed circumstances, it is more pertinent to inquire as to how we may avoid having to pay prices which are at—or even above—the upper limit of this price.

The issues involved are of course so complicated that drastic oversimplification is necessary if the problem is even to be stated concisely. Supply and demand are themselves functions of price, and so also, in the long run, is the energy-intensity of the economy. Both the upper and the lower price limits may change over time. Prices paid may not reflect the total cost of petroleum production and consumption to the economy and the environment. Prices which do not permit environmental conservation may be too low, while the prices necessary to achieve environmental enhancement may be too high. Prices paid for strategically insecure oil may be in some sense too low during normal times, but much too high during periods of emergency. And, correspondingly, prices paid for secure oil supplies may seem too high (to consumers) during normal times, but too low (to producers) during intervals of supply crisis.

The foregoing remarks are intended merely to suggest that one's assessment of the optimum price for oil depends upon several things—not only upon production costs for petroleum but also for other sources of "synthetic" liquid and gaseous fuels; not only upon production costs in physical terms, but upon costs of resource acquisition where these may include bonuses, royalties, tribute, and other forms of economic rent; and upon the extent to which one judges that prices should cover the costs of environmental protection.

It is my understanding that during this hearing the International Economics Subcommittee wishes to investigate the current proposal that the major oil consuming countries agree to establish a common floor price, to protect new energy sources from becoming uneconomical if world petroleum prices were to decline sharply. Accordingly, I shall attempt to provide brief answers to the eight questions listed in the April 23 press release which announced this Hearing.

(1) Is the price floor the most efficient way to encourage domestic production needed to attain the desired level of energy self-sufficiency? If so, at what level

should the floor price to set to protect energy investments in conventional and synthetic fuels against a future international price decline?

I do not believe a floor price would be the most efficient device for achieving such a purpose. There are several objections to such a plan. (1) The provision of an explicit price floor bolsters the monopoly power of the exporter cartel, by reducing the motivation of exporters to even consider offering price concessions. As I stated in my appearance before this Subcommittee last year, the most important task of the importing countries is to form an importer cartel for the purpose of forcing down buying prices—and not to create obstacles to such declines. (2) The proposed scheme is probably not feasible. The different importing countries can scarcely be expected to agree upon a common price floor (unless the price floor is so low as to be meaningless) since their interest in high ducers as well as consumers of energy resources. It would be logical for the United States and the countries sharing in North Sea oil production to favor a relatively high floor price, while importers like Japan, with no prospects for indigenous fuels industries, would logically prefer no floor at all. (3) Alternative devices, such as direct subsidies to higher cost producers, appear to be more efficient—a point which is discussed in the answer to question 4.

But if we assume that floor prices are instituted, in spite of the above objections, at what level should they be set? The level of the price floor depends primarily upon the degre of domestic self-sufficiency which is sought. If complete elimination of imports is sought, such a floor price would have to be unrealistically high, unles the goal is to be achieved only at the end of a very long period of time. Even a lesser degree of self-sufficiency would obviously require the production of liquid and gaseous fuels from other sources than crude petroleum, and the prices required to obtain substantial supplies of synthetic fuels are a matter of conjecture, but they would appear to be quite high. My own studies on the economics of synthetic fuels are now out of date, but my assessment of the more recent work of others suggests that costs of coal liquefaction are disappointingly high, at perhaps $12–15 per barrel for first-generation commercial scale plants. Although costs per barrel should decline over time as production experience accumulates, it is rather doubtful that such cost declines would greatly outpace expected rates of inflation, particularly as they affect the cost of facilities in capital-intensive industries.

Hence it is possible that a price floor of over $15 per barrel might be necessary to provide the desired degree of reliance upon domestic production—and even so, the supply additions would be forthcoming only over a period of many years. As for the price floor needed to induce substantial additional output from conventional petroleum reservoirs, this is also a matter of considerable uncertainty. In 1973, I made studies of the long run supply schedules for oil and gas for the period through the year 2000, for a variety of cases. The most optimistic case did not assume complete self-sufficiency, but merely that the U.S. would be capable of producing enough oil to keep reliance upon Eastern Hemisphere imports down to 19 per cent of total consumption, and that the ratio of reserves to production would be no lower than 8 to one by 2000. The necessary price required to achieve this goal was about $7.50 in 1972 dollars. Inflation since 1972 would increase the price to about $9.50 in 1975 dollars, and the elimination of depletion would probably require a further increase to about $11.00 to compensate for higher per-barrel tax payments—although the latter computation is difficult to estimate because of the variety of possible responses of the petroleum industry to the removal of depletion. Thus, $11.00 per barrel might be a very rough estimate of the supply price necessary to achieve one version of self-sufficiency from more intensive exploitation of petroleum resources, while $15 or more might be required to achieve a greater degree of import indepedence through the development of synthetic fuels. Such high floors can be expected to have little appeal to U.S. consumers, and still less for buyers in other importing countries.

(2) What would be the effects of a floor price on the structure of the energy-producing industries both domestically and internationally? Would such a floor facilitate investments by new companies needed to maintain a healthy and competitive domestic industry or merely provide greater benefits to existing major companies?

In itself, a high floor price would naturally tend to increase investment in energy industries throughout the world, relative to a situation in which no such floor was provided. A very high floor guaranteed by all the consuming nations would eventually stimulate enough exploration and discovery to create considerable excess producing capacity even outside the export cartel, although this is likely to be a factor only in the very long run. If a high floor price is

guaranteed by only one or a few importers, the worldwide effect on exploration and discovery will be correspondingly reduced. The petroleum industry is definitely an industry of increasing marginal costs, such that higher prices are required to achieve higher rates of production. In general, the expectation of a high future price level would mean more intensive development of existing fields and more extensive exploration, particularly new and higher cost areas such as offshore and Arctic drilling. Riskier investments would be undertaken, and more would be invested in attempts to perfect methods for increasing recovery from known reservoirs.

The effect of a high floor price on future costs of energy production is hard to appraise. More money spent on research, particularly in successful research on methods to detect directly the presence of oil in underground formations, might eventually pay off in terms of greatly reduced costs of exploration, just as successful research in field development might decrease unit costs of production. It is not prudent, however, to depend too heavily upon the possibility of such favorable outcomes. The basic fact is that higher prices will justify higher cost marginal operations, and thus at the margin of economic viability in any region, higher cost production will persist. A high price floor will without doubt facilitate new entry into those phases of the industry requiring relatively moderate initial investment, such as onshore drilling in the more accessible locations. It is not to be expected, however, that price supports in themselves will greatly increase the relative share of oil and gas production controlled by the smaller operators.

(3) Would a minimum price for oil imports affect future costs of domestic energy production by inflating the purchase price of oil leases?

In theory, if competitive bidding occurred for a mineral property known with absolute certainty to contain a definite volume of ore deposits, and if future prices and production costs were also known with certainty, then the "lease bonus" or other lump-sum cash payment for the right to exploit the deposit, would amount to the entirety of the excess of total revenue over total costs (including in costs the necessary competitive rate of return on investment) after discounting for the time pattern of future costs and revenues. Under such circumstances, any price increase without a corresponding cost increase will merely increase the lease bonus and leave everything else constant. The presence of uncertainty, however, is the primary fact of minerals exploration, and cannot be overlooked. This uncertainty involves both the existence and extent of mineral resources in a given tract, and their probable cost of exploitation. A relatively high floor price will shift the margin of new exploration outward from more familiar areas to less familiar areas. This means an increase in the degree of uncertainty associated with the typical new venture. Lease bonuses will be rather highly discounted for uncertainty, since a cash bonus paid in advance of drilling places all the risk of exploratory failure on the bidder. On the other hand, royalty bidding, which shares the risk of dry holes between operator and land owner, would not be affected quite so much by uncertainty. Hence the answer to this question appears to be that, while there is some tendency for oil lease prices to rise, this effect would not be a major factor since it tends to be obscured by allowances made to take account of uncertainty. It should also be noted that the elimination of percentage depletion will be an offsetting factor which will tend to reduce lease bonuses.

(4) What are the principal alternatives to the oil floor price proposal? Would a well-targeted program of direct and contingent subsidies be a less costly way of developing needed energy resources than maintaining a floor price for imports?

The institution of a price floor at levels necessary to provide this country with a substantial degree of import independence in the long run, would mean a price increase, which would raise the price of all petroleum purchased. At least for the time being, I would prefer to see domestic oil and gas prices freely determined by supply and demand. The main advantage of a price floor is in investment planning. If a floor were to be set at a level below the current price for new oil, it would serve the useful purpose of providing companies with a minimum price guarantee for investment planning calculations. But if world prices declined, domestic prices would not be allowed to fall under the proposed price floor plan, and domestic buyers would pay higher prices than those who purchased elsewhere at the world price level. Protection against price declines might, however, take the form of direct subsidies to producers whose costs exceeded the reduced world price. The employment of this device would permit consumers to purchase at the lower world price, and the cost to taxpayers would be direct subsidies

which would differ among producers in accordance with the gap between their production costs (including profit allowance at a risk-adjusted competitive rate) and the market price. The total cost to consumers plus taxpayers would be less under a direct subsidy arrangement than the total cost to consumers under a price floor plan. The obvious drawback to this type of direct subsidy plan is that it requires the determination of unit production costs for all producers whose costs drop below the reduced price. The problems of cost determination are particularly difficult in petroleum, although such difficulties as will arise need not prove insuperable. Similar subsidy arrangements for producers of certain metals were implemented during the second world war. Another feature of subsidies is that total consumption is generally greater under subsidies than under price supports. Whether this feature is an advantage or a disadvantage in the context of the petroleum market is considered in the answer to the next question.

Production of synthetic liquid fuels is a special case; here the required price would be too high to serve as a floor price, and some sort of subsidy arrangement would be necessary. A number of arrangements are possible. The government might build synthetics plants of its own, which it would lease to operators, as was done with much wartime industrial capacity expansion during 1942–1945. The terms of the leases could achieve limitation of profits to competitive levels in a number of different ways. For example, production could be sold at the prevailing market price to buyers, and the seller would be reimbursed for the difference between this price and the seller's computed unit cost, by way of a subsidy payment per unit. (If cost fell below price, a negative subsidy would be levied.)

(5) Should a floor price be used to prevent increased energy consumption if world oil prices dropped significantly? Would taxes on energy consumption and on inefficient energy use be a more desirable way to promote energy conservation?

The desirability of limiting consumption growth in the event of a price decline depends of course on the reason for the price decline. The appropriate response to a price cut dictated by cartel strategy would differ from that reaction which should follow a price collapse resulting from the demise of the cartel. As long as the cartel is a threat, reasonable steps should be taken to limit imports, which means not only increasing domestic supply, but moderating domestic demand. Clearly, higher domestic prices accomplish both goals—although admittedly rather slowly. But while rapid increases in production are desirable but (for logistics reasons) impossible, rapid reductions in consumption are possible but undesirable. At the present time, a rapid decrease in consumption would be highly detrimental to our less than resilient economy, intensifying its current symptoms of both depressed production and price inflation. Wasteful consumption of energy should of course be curtailed; increased prices will provide an incentive. Concerted efforts to reduce consumption by differentially penalizing energy-intensive operations should be carried out more gradually over a longer time horizon. One of the advantages of direct subsidies over price floors is that the former can be employed in such a way as to facilitate the transition period between high and lower consumption more readily than can the latter.

The question as to whether specific taxes would promote energy conservation more efficiently than higher fuel prices is too difficult to answer without extended study of actual market situations. It would not be easy to identify the optimal set of taxes, and choice of a suboptimal set might easily result in a situation much inferior to a simple increase in fuel prices. (It should also be kept in mind that regulations designed to promote one goal, such as air pollution control, may not be consistent with those designed to promote apparently related goals, such as fuel use reduction.)

(6) Does a minimum price agreement effectively provide a price guarantee for oil exporting countries as well as domestic producers? Would such an agreement also provide the appearance of confrontation needed to perpetuate cartel unity and pro-rationing of cartel oil production?

The answer to the first question is yes. By and large, a floor price would give sellers no incentive to reduce price below that floor—this is one of the major drawbacks of the entire scheme. As to the second question, I do not know if such an agreement would provide the appearance of confrontation; it looks more to me like accommodation. But I hope it would be perceived as confrontation, which is long overdue. It is a mistaken idea that a monopoly of supply can be offset by a monopoly of self-restraint on the part of importers. Putting pressure on the cartel is salutary; it is more likely to increase existing strains than to "perpetuate" unity.

(7) Is a common floor price in the interest of the other major consuming countries and can these countries afford to stick with a price agreement if competitors begin to use cheaper oil? What would be the U.S. response if our competitors chose cheaper oil?

As indicated in the answer to the first question, it is not in the economic interest of countries with differing prospects for energy self-sufficiency to adopt the same floor price. Those countries whose economies are most dependent upon low cost energy imports would be least able to abide by agreements once other parties to the agreement abandoned their commitments. The U.S., as the least import-dependent of the consuming countries which might be parties to an agreement, could best afford to adhere to the agreement even if other members were defecting. While there would be definite foreign trade disadvantages of adhering, it would still promote import independence.

(8) Is the proposed minimum price the first part of a move to reach a commodity agreement on oil between the consumers and the cartel?

If the proposed minimum price is the first part of a move to reach a commodity agreement, the agreement reached may be a disadvantageous one, depending upon the height of the adopted floor price. The floor price scheme is better conceived of as a defensive alliance among importers; there is no reason to believe that the exporters would feel themselves bound by the terms of any commodity agreement.

Chairman REUSS. Gentlemen, you have all been critical of the floor price proposal. Apart from certain members of the administration, who have been quite enthusiastic about the proposal, can you tell me of anyone, either in industry or in the academic world, who supports the floor price proposal?

Mr. LICHTBLAU. You mean outside of Mr. Kissinger?

Chairman REUSS. And Mr. Enders. I think there are at least two. Is there anybody else?

Mr. LICHTBLAU. That is all I came up with.

Chairman REUSS. Is there any other?

Mr. KING. No.

Chairman REUSS. Your testimony, Mr. King, was particularly instructive because you represent one of the most dynamic petroleum companies in the world. You do not like it and you gave your reasons very forthrightly. Is there any of your competition who is in favor of this kind of proposal?

Mr. KING. We have found very little enthusiasm, and I cannot mention any single, specific company who does support it in the industry. The petroleum industry historically has been willing to take a risk as long as the economic environment in which they are operating provides an opportunity that the successful production plays will offset the costs of the unsuccessful ones. Our problem is that any time you superimpose on that situation a control mechanism, what you tend to do is prevent us from taking advantage of the successful ones and leave us with the liability of the unsuccessful ones. And so our evaluation of and our ability to accept risks is greatly reduced and we have got to be much more careful. This means that the effort involved in producing the energy and the jobs involved in putting people to work to do so, all diminish, and, of course, this is exactly the opposite direction to that in which we need to go.

Chairman REUSS. Mr. Steele, I think, you recalled the system to develop resources that was used in World War II, not with petroleum but with various minerals.

Mr. KING. Synthetic rubber.

Chairman REUSS. Right. A bulk line system approach where the Government, recognizing what is needed, pays a subsidy to a high-

cost producer. Subsidies paid vary, depending on the costs. Actually, that program was mostly successful, was it not?

Mr. STEELE. I believe so. Surprisingly so.

Chairman REUSS. In helping to win the war and supplying the production that was needed and at a relatively low cost to the taxpayers. Is that not a correct recollection?

Mr. STEELE. Yes; I would believe so.

Chairman REUSS. Mr. King, you have a good memory.

Mr. KING. Yes. In regard to those fields of activity where the resource base was known, you knew where the metal was or the coal was or the synthetic rubber plants were, they took a significant risk on the technology and did an outstanding job. Similarly, in the synthetic fuels, this kind of an approach could be used. I have a very hard time rationalizing that kind of an approach with oil exploration, though, because here you are in the unknown. For instance, on the MAFLA sale, the industry put some $80 million down the drain and so far has come up with nothing. It is a completely different situation, because you never know whether there is oil and gas in the ground until the drill bit goes down to the bottom of the structure. It is going to be extremely difficult, in my mind, for the Government to encourage oil production by using the kind of a program that they used during the war to sponsor the uranium enrichment plants and the synthetic rubber plants and this type of thing.

Chairman REUSS. But, as you earlier indicated in your testimony, a floor on import prices does not provide a rational incentive either?

Mr. KING. No.

Chairman REUSS. So we must look elsewhere, and you have given us some suggestions.

I have just one question of Mr. Branson in this first go-round. Under your listing of the three things to avoid, your first was that we should not raise taxes to cut energy consumption. Are you opposed to what the Ways and Means Committee is now working on: namely, a progressively higher tax on gasoline to decrease the nonessential use of gasoline?

Mr. BRANSON. I think so. I have not done any detailed calculations about this, but it seems to me that if one thought that 4 years ago that gasoline consumption was excessive socially, and at that time was for a tax to reduce gasoline consumption, that the increase in price that we have seen recently should at least weaken the argument for a further increase in that tax rather than strengthening it.

But the major point I wanted to make here was that I think that the question of environmental or conservation considerations should be separable from the question of a suitable response to the change in the market structure in the oil industry, and that one should go at that by asking more direct questions about alternatives like horsepower taxes and car-weight taxes, if one is trying to go after automobile consumption of petroleum products. But, my impression is that the concern about a proper response to the increase in price by the cartel has merged in a confusing way with environmental and conservation concerns in general, and produced an internally contradictory coalition for raising gas taxes.

Chairman REUSS. But, from what you said a moment ago, you would favor a tax on high-horsepower or gas-guzzling automobiles,

does that not serve a joint purpose of cutting down on air pollution, and preventing our mortgaging ourselves too much to the OPEC countries. What is wrong with having two reasons for one action?

Mr. BRANSON. I just want to make sure we understand there are two separate issues. The tax on automobile consumption of gasoline would tend to reduce demand for gasoline and reduce the price rather than increase it, which a tax on gas itself would do. So it seems to me you would not want to go at the problem by taxing gasoline. But, I am not sure, since I have not done any detailed calculations about this, that even taxing consumption of gasoline is necessary. It is not obvious to me that our automotive consumption of petroleum products is socially excessive. It is not clear to me that the foundation in analysis is for that, rather than an emotional view that cars are just a bad thing.

Chairman REUSS. We will leave aside any environmental or social questions. There is just one point which I think has some validity, and on which I concur with the administration: If we endlessly let reserves pile up in the hands of the OPEC countries, and endlessly accumulate foreign-owned debt, we get into a position where economically, carrying the interest charge on that every year, will diminish our real income and politically we will be more easily blackmailed. So, I think there is some point in having a limit on the size of the mortgage that OPEC owns on the United States. If that is so, why not use the excess tax mechanism to discourage frivolous driving?

Mr. BRANSON. As I tried to say in my statement, it seems to me a better way to go about that is increasing domestic production rather than reducing domestic consumption, if what we are concerned about is the import difference. I think that is a way which is less painful to U.S. consumers.

Chairman REUSS. No doubt about that. But are you not merely inviting more frivolous use of gasoline and a larger mortgage because people will just buy and use more gasoline if you are going to increase domestic production?

Mr. BRANSON. Not if the price does not come down. I am suggesting that increasing domestic production would substitute for imports and serve the purpose of reducing the import bill. The other side of this, I think, is that most of the calculations by the people at the World Bank, for instance, say that debt to the OPEC countries that is piling up is not going to pile up endlessly, that they will get to balanced current accounts at a point that is somewhat distant, but still foreseeable. So, I would think that the concern about debt to OPEC countries piling up endlessly is not a relevant one, regardless of what we do about a tax on petrol consumption or petroleum products generally. I think one could think about that separately from concern about the financial implications of the size of that deficit piling up. And I would much rather go at it on the production side.

To answer your question about whether that would not encourage consumption, if production is expanded against some given world market price, then it is not going to lower the internal price, rather it is going to substitute domestic output for imports.

Chairman REUSS. But, it sure is going to make it harder to induce Americans to drive at 55 miles an hour when you let the cat out of the bag that we have oil flowing out of our ears. An interesting question. We could pursue it for a long time, but my time is up.

Congressman Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman.

First, I cannot tell you how delighted I am to see four such distinguished people with different backgrounds unanimously opposing the floor price. It just seems to me to be total madness, and I do not understand why a man of as obvious intelligence as Secretary Kissinger should become wedded to this plan. I hope your testimony will cause a rethinking of this idea.

Mr. King, in your prepared statement you said you detected some softening of prices, but you do not see any predatory pricing practices by the OPEC countries. Are you saying that if we just let the law of supply and demand work that we will see a reduction in oil prices?

Mr. KING. I would like to ask Mr. Blackledge reply to this question. He is intimately knowledgeable in the international oil scene and can give a more expert answer than I on this.

Mr. BLACKLEDGE. Thank you, Mr. Chairman.

Within the last 3 months we have seen evidence in a half a dozen of the OPEC countries that some special arrangements can be made. We have been offered oil at better credit terms or slightly lower prices or some kind of a commodity trade that would allow the price of oil to come down. Not a great deal, but I would say since the first of January that throughout the OPEC nations there has been an effective drop of about 2 percent in lowering of oil prices. Now, 2 percent is not very much, but that is only over about 90 days in which this has happened. Some of the countries are actually starting to run short of money. They have spent money so fast on expectation of increased volumes that now that there has been a reduction in the total consumption of oil they are looking around to see what they can do. I do not see a major break in the oil prices, but I think this erosion will continue, and if the erosion continues long enough, it will some day lead to a break.

Representative MOORHEAD. Do you see this softening in what I would call the high consumption countries like Indonesia, Nigeria, Iran rather than in, let's say, the Persian Gulf sheikdoms where they have more difficulties spending the money?

Mr. BLACKLEDGE. Well, yes. The countries, Iran and Kuwait, have probably been the leading ones holding firm on prices. In Nigeria, there has been weakening and in Indochina there is some evidence of weakening. Some of the smaller sheikdoms in the Arabian Gulf tend to be spending the money more rapidly than it is coming in. They are looking for other opportunities and things that can be done. I would say that the softening process has just started. I would think that it would increase over the coming months, and it may someday lead to the price break that we have talked about this morning.

Representative MOORHEAD. Thank you, Mr. Blackledge.

Mr. King, in your prepared statement, you say in most cases this technology has not been proven on a commercial basis. Right across the street from you, your friends from Koppers say that they have a coal gasification technology which has been proven commercially viable, and I think they said they have some 14 coal gasification plants in various parts of the world, although none in the United States.

Mr. KING. If my recollection is right, these coal gasification plants produce a lower Btu gas and this has been long established. In Philadelphia, for example, some of the city plants used to be low Btu gas.

and in Great Britain for years they used low Btu gas. This is maybe 350 to 500 Btu's per cubic foot instead of the 1,000 that natural gas has.

The problem here is that, because of the inerts in the gas, in most cases you have to use a different burner. You cannot mix it with the natural gas because then you dilute the energy content. In many cases, the low Btu gas has some carbon monoxide which, of course, is quite poisonous and if there are leaks you have to rectify the leak almost immediately. So, it is not a viable solution to our gas situation.

To go from the low Btu gas to high Btu gas requires a process called methanization, and this, on one scale of application has long been used in the chemical industry in making fertilizer. To use it on the scale that is required to go to high Btu gas requires a much more intensive engineering application. Recently, the industry on a joint basis ran such a test in Scotland, using existing equipment. They feel that, based on that information, they are in a position where technically the risks are digestible, but are still unknown. This operation has not yet been used commercially. Of course, the main problem is financing; that is, financing the very high cost of such an operation which has gone from maybe $400 million for one commercial-sized plant to close to $1 billion. The price controls on gas have made it a situation where nobody can move on such projects. I think ultimately it will come, and I think it will have to come, but we are not there yet.

Representative MOORHEAD. Mr. King, you talk about demonstration plants in shale oil. Do you include in that recommendation eastern oil shale or just western?

Mr. KING. I would think primarily western, because that is where the biggest and the richest reserves are. It would seem logical that you would want to put up the first projects in the prime resource location, and if it works well there, why then you can extend it to other areas.

Representative MOORHEAD. Now, not directing this to any specific one of the witnesses, but it would seem to me contrary to what Mr. Branson said, and maybe more along the line of what Mr. Steele said, that if we do reduce consumption we are more likely to bring about the erosion of the prices as Mr. Blackledge stated. Would that not be a correct proposition?

Mr. STEELE. Well, we want to reduce imports. We will reduce imports by cutting consumption or by increasing our production, and in my prepared statement I warned against the danger of rapidly reducing consumption, however, at this time.

Representative MOORHEAD. I did notice you said a long horizon, but it seemed to me that the more we reduce consumption, particularly as you point out wasteful consumption, that we are in a better position to do without as much imported oil. Is that not correct, sir?

Mr. STEELE. Well, that is true. It just depends on what the domestic cost will be of reducing consumption, and in what categories. It is naturally a very complex question.

Representative MOORHEAD. Let me ask you, sir, if the President decides to proceed with his proposed import fee increase in May, what do you think the Congress should do?

Mr. STEELE. Well, they should oppose it. I think it is the wrong way to reduce consumption. It would tend to bolster foreign prices.

Mr. King. Congressman Moorhead, I would like to make two comments on that. One is that the oil consumption worldwide now is down about 11 percent from what it was in the first quarter of 1974 and that, of course, was the period when the embargo was on, so I guess the OPEC nations are down close to 20 or 25 percent. However, we should realize that a good portion of this reduction is because the economies are very slow throughout the world—in Japan, Europe, and the United States. Now, if the economy should turn around again and start to revive, then the demand for fuel would have to go up. The two are inextricably intertwined. We could be in a position then, as the economies go up, where we will start to have to import more and more oil.

Now, it would seem to me that the thing we want to do is encourage our domestic energy production. If the Japanese or the Germans were sitting on top of the resource base that the United States has, they would many months ago have rapidly gotten after this development program. We are not doing this because we feel we can afford this luxury, but we really cannot. It would seem to me that the one alternative would be to put a tariff on the imports of crude oil, and back out an equivalent amount of money from our present excise taxes on domestic fuel so that the consumer does not pay any more, but the person who is importing the foreign oil will have to pay more. But, if you do that, then you are going to have to take a look at the entitlements program, because presently the entitlements program encourages imports.

If, for instance, the ratio of "old" crude oil to crude runs about 35 percent and you are running 100 barrels of crude, if you have 36 barrels of old oil, then you have got to buy an entitlement which costs you money. If you import three more barrels of old oil you don't have to have any entitlement, so you have yourself a $2 built-in subsidy per barrel for imported oil. This whole regulatory problem in trying to remove one inequity just creates other problems and is very complex.

What this all resolves down to, I think, is that we do have an extensive resource base. I cannot foresee that we could provide enough domestic energy to the point where we would be swimming in energy. We are importing now 6 million barrels a day of oil. We are producing now 8½ million barrels a day of oil. To back out all of those imports I do not think is possible within a reasonable time frame and the expense would be tremendous. But this does not mean that we should not undertake a major effort in developing our own resources.

You know, we have got the best of both worlds here. We can create employment, we can stimulate our economy, and what we would be doing would be backing out oil payments to foreign nations. We would not be creating a product for which there is no market. So this must be a leading national priority.

Representative Moorhead. Thank you. Thank you, Mr. Chairman.

Chairman Reuss. Congressman Hamilton.

Representative Hamilton. Thank you, Mr. Chairman.

In response to a question by the chairman a moment ago, you indicated you did not know anybody who supported this common oil price. You are referring, I think, to people here in the United States. Has there been any favorable reaction abroad to it? What is the attitude of

the OPEC countries? What is the attitude of our European and Japanese friends?

Mr. LICHTBLAU. May I answer? I was over in Japan about 2 weeks ago and discussed this specifically with the people who were delegates at the IEA and they are very strongly opposed to it. In fact, they think that they could not possibly survive politically if they were in favor of the kind of floor price that has been suggested. A floor price of $4, $5, $3, or that sort of thing, of course, would be acceptable because it is an unrealistically low floor price and has no meaning, but any kind of a meaningful floor where it is possible that world oil prices might drop lower than the floor price, would be probably unacceptable to the Japanese, from what I was told over there a couple of weeks ago. And the same thing applies, I would think, to all of the oil importing nations which have no resources of their own. You have a dichotomy there between the resource producing members of the IEA and those who are not, who are totally dependent on imports.

Representative HAMILTON. What bothers me here is how a recommendation like this gets made. I suppose you gentlemen are not experts on this. I am certainly not.

But here is a suggestion that has been made by the President as a major part of his energy program. It is a very serious proposal, and yet so far as we are able to determine, outside of two or three people in the administration, nobody is for it.

What disturbs me is that the process of decisionmaking seems to be very faulty here on the part of the administration. Why is that? Do you have any knowledge of how that can be?

Mr. BRANSON. In answering the chairman's question originally, I think I at least should have said more precisely that I do not know any economists who are for this. I think there is some feeling among political scientists in universities that this is a good thing. I think there is a vague feeling that it is important for the United States to pick up leadership in the OECD industrial world which has fallen apart in the last 3 or 4 years.

Representative HAMILTON. Putting forth a proposal that nobody supports is not exactly the way to regain leadership.

Mr. BRANSON. Well, I am not supporting it. I am just trying to understand it. And I think some academic political scientists view that situation as having deteriorated sufficiently that they would support almost any indication that the United States was trying to take a policy initiative that would provide leadership among the industrial countries. This may reflect some concern in the administration about that.

Representative HAMILTON. Mr. King. I was interested in your observations about the spending in the oil producing countries. Your statement says that several countries are already spending internally the major proportion of their revenues. Are you concerned about the piling up of excess oil revenues? Your statement would suggest to me that you are not, and that they are going to be able to spend about everything they can get. Could you elaborate on that?

Mr. KING. Yes. I will be glad to. We are not at all concerned about this for several reasons. One is that, as you know, it is a classic failure of human nature that you always spend as much as you have, given time to digest this. This is true of individuals and it is true of nations. The imports in 1974 of the OPEC nations went from $28 billion to,

I think, something like $45 billion in 1 year, a tremendous jump. As a result, the amount of money that had to be recycled, the so-called petro-dollar recycling, was not as large as had been anticipated, and the international financial system did a remarkable job of digesting this tremendous change in dollar flow.

The volume of oil revenues is still high, but the abrupt change has been digested. Some of the exporting countries deliberately plan to maintain a cash surplus, because as the oil runs out this will be a source of income for them to support their economies in the future. What can they do with this cash surplus? They cannot put it in a safety deposit box. There is just too much of it. There is no place in their own country to invest such huge sums. They cannot invest it behind the Iron Curtain with any prudence. So they have got to invest it in the West, in the industrial countries of the free world, Germany, Japan, and the United States. As more and more of this accumulates, they are going to become more and more hostage to us in a sense, and that is that it will be to their disadvantage if our economies falter because of high fuel prices. Their investments here will tend to help stimulate the economies here, and I think that this will level out much more rapidly than most people think.

So, we feel that such investments are really an advantage.

Representative HAMILTON. You are saying a little different thing than the implication of your statement. The implication of your statement is that they are going to spend the money internally. Now you are saying there will be quite a pileup for investment purposes.

Mr. KING. It is very difficult to make generalizations. Iran could probably fairly easily spend all of its revenues internally, if it is not doing so already. I think the Kuwaitis will deliberately not spend all of it internally for a number of reasons. They have a much smaller population, they have been reinvesting in their own country for a longer period of time, and they are already fairly well developed in their economy there.

Libya is going to have a very difficult time investing all of the money in Libya. Nigeria probably will be able to, and Indonesia now is already running short of the money, and countries like that could be expected to. But, I think there will be a number, such as Kuwait and possibly Libya, which as a matter of policy, will try to invest money in long-term investments, such as real estate, so that on an ongoing basis future generations can realize income from it when the time comes that their oil resources are depleted.

Representative HAMILTON. Your colleague—I am sorry that I did not get his name——

Mr. KING. Mr. Blackledge.

Representative HAMILTON. Mr. Blackledge, you spoke about expecting an erosion in oil prices that could lead to a sharp drop. Do you see a possibility that OPEC will become unstuck?

Mr. BLACKLEDGE. I would say that given a period of time, OPEC will come unstuck. Now, how long that period is, I don't know, but there are tremendous differences, historical differences, between a number of the OPEC countries and they are, in my opinion, certain to fall apart someday. Now, I cannot predict when that someday is. Possibly, if all of the current political problems in the——

Representative HAMILTON. They have shown so far, at least, a very good ability to stay together on prices, to the suprise of those of us in

the West. Why would we not expect them to keep that kind of unity and jack the prices up more on us? Do you think the alternative sources of energy and the additional exploration will foreclose that possibility?

Mr. BLACKLEDGE. Given a period of time, yes. It was easy for the OPEC nations to stay together as long as every barrel of producible oil is being produced and consumed, and they could raise the price and still had every barrel moving. Today, as Mr. King mentioned, the demand for oil in the free world is probably about at 1971 levels. The increases that were expected 2 or 3 years ago have not taken place. In fact, there has been a falling of demand. There is excess productive capacity in most of the OPEC nations.

Now, they can reduce production and it works, but it is not as easy to hold a group together when production is falling, as it is when production is increasing.

Representative HAMILTON. May I ask Mr. Lichtblau and Mr. Steele if they agree with the general approach Mr. Blackledge has indicated here with regard to the prices of oil?

Mr. LICHTBLAU. Well, it is clear that oil prices are eroding at the moment, and I was very interested in the 2-percent decline mentioned by Mr. Blackledge. That seems to make sense, and generally, I think that is the evidence we have seen. How much further prices will go down is difficult to say. I think as there is a possibility in a fairly short time, that this huge overhang of excess productive capacity will become somewhat smaller, partly because, as Mr. King said, there is likely to be an economic recovery around the world, and the other reason is that there is currently a great deal of oil inventory reduction in the importing countries.

Now, that is limited, and inventory reduction cannot continue, so that when that is over there is a good chance that oil exports from the OPEC nations will rise somewhat, and that the surplus will decline somewhat.

When we talk about the surplus, and we usually mention something like 12 million barrels a day, which is a huge surplus, it should be recognized that this is the physical surplus. But all of these countries have established production limitations. You may count, say, Saudi Arabia at a productive capacity of, let us say, 11 million barrels a day, but they only permit 8½ million barrels a day allowable production, and the same thing applies to a number of the other OPEC countries. So the real excess capacity is not quite that high. It is about 7 million barrels a day.

But I agree with you that OPEC is a very dynamic, very strong organization. They are far from being through or far from collapsing. Every human institution eventually collapses or is changed, so I would agree that OPEC will someday disappear, but that could be quite a way off.

For the foreseeable future, between now and the early 1980's, let us say, I foresee OPEC continuing, being strong, and in some way determining the world oil price within the limits of excess production and the realization that if oil prices keep rising, OPEC's excess productive capacity is going to rise, too. So, they have this awareness, and this is why you see a small price drop.

But OPEC is more than a price-fixing cartel. OPEC is an ideology. I mean, the countries who came together there have a sense of purpose. This is a revolutionary change, a transfer of huge amounts of money from the industrial countries to the third world, and I think there is so much political support for this that it is difficult to see in the next several years OPEC collapsing or becoming a meaningless organization which just continues to function but with no real power in determining world oil prices.

Representative HAMILTON. My time is up. Mr. Steele, maybe you would like to respond.

Mr. STEELE. Well, I think economists have tended to underestimate OPEC's strength because they regard OPEC as a cartel like many previous cartels in world commodities. But the difference here, I think, is that commercial cartels are based on greed, and while OPEC is based on greed, it is also based on hatred and on the desire for revenge, and these are very powerful motives, and they can cause persistence in uneconomic decisions.

Representative HAMILTON. Thank you, Mr. Chairman.

Chairman REUSS. The supporters of the floor price frequently bring up the American coal industry and point out that it would be particularly susceptible to a sharp price decline; hence, the oil price floor is needed for that reason. Would anyone care to comment on that contention?

Mr. LICHTBLAU. I would say, Mr. Chairman, under title IX the consideration of coal is excluded, and that title IX, under which this floor price concept would take place, specifically talks about domestic oil production and oil exploration. It does not recognize any other domestic energy source. So while there may be an argument made for coal, it is not made in the administration's proposal.

If there is a fallout for coal, it is indirect and coincidental, and it is not part of the administration's request.

Chairman REUSS. Part of the request or not, what do you have to say to the question of the alleged particular susceptibility of the coal industry?

Mr. LICHTBLAU. Well, I think the limitations on coal, and I think Gulf knows more about it because it has a large coal production, but I think the limitations on coal are environmental and the ability to increase production. Coal production has risen sharply since OPEC prices went up, and coal prices have gone up very sharply. And I think if environmental standards were changed—I am not saying they ought to be—but if they were changed and you could burn more coal because you could ignore sulfur content or at least some of the sulfur content, you would see an immediate attempt to increase coal production. And if strip mining of coal were permitted in the West, you would also see an immediate, sharp increase in coal production from that area.

So the limitation on coal production is by no means the fear that OPEC prices might decline, but domestic legislative restrictions as well as environmental problems, as well as the fact that the principal buyer of coal—namely, the electric utilities—are now finding that their projected increase in electric power may have been too high and there may be some retrenchment of new plant building. Finally, to the extent to which utilities build atomic-powered plants, they may build fewer

coal-fired plants. All of these are considerations, but not the OPEC prices.

Chairman REUSS. Mr. Branson.

Mr. BRANSON. I think that that argument is not particularly an argument for the floor price.

Chairman REUSS. The argument of the coal industry's alleged susceptibility?

Mr. BRANSON. There is some difficulty with the coal industry, and if the coal industry were free to expand and did so, and then there were a price break in oil, then the coal industry would be in trouble again. But the basic question is do you want some kind of legislation to protect the coal industry from that kind of a price drop in a competing energy source. And if you do, there are many ways to protect it. You could protect it the way we protect U.S. farmers, or you could protect it by putting a floor on all energy import prices. But it is not clear to me why the possibility of a fluctuation in coal output, which would be inefficient in moving resources into coal and back out, is an argument for the floor price as opposed to any other way of protecting the coal industry against another drop in energy prices if they gear up to produce the amount of coal that would be demanded, with oil selling at current prices.

Chairman REUSS. You say that the coal industry has expanded production a good deal in the last year?

Mr. LICHTBLAU. Oh, yes.

Chairman REUSS. All witnesses agree? I just don't know.

Mr. King.

Mr. KING. On that specific aspect, I think the production is running now about 630 million tons a year. It was 580. It is very difficult to compare last year with any period now, because of the strike last year, which had an unusual effect. It tended to increase coal production before the strike and, of course, the coal production was decreased during the strike. But there is no question that production is up and is going to continue up somewhat. The prices are the reason why. The prices have gone up considerably and a lot of the mines that were formerly unattractive or marginally attractive can now be operated at higher rates. The price has gone up enough that I doubt that a floor price would really be of any particular help.

One thing in considering coal you have got to realize is that it is very difficult or essentially impossible to switch most of the coal-burning facilities to oil, or from oil to coal, quickly. For this to be practical, a company has got to build in a dual-fuel furnace, this costs extra money, and that is a lot of insurance money for something that may or may not happen. Generally they do not do this because of the capital and financing problems. Acquiring the capital is very difficult for these utilities nowadays. So on the short term, if the oil prices were to fall precipitously, it would not really affect the coal consumption of the utilities because they cannot shift over that rapidly. If the oil prices stay down in the long term, you have to ask yourself will the public, the U.S. public, sit still for paying higher electric prices based on coal when oil is plentiful and at cheaper prices. I think the answer to that is no. So, again, we come up with something that really we feel is an impractical approach.

The main problem, as Mr. Lichtblau pointed out in coal, is the sulphur and the environmental problem. Synthetic fuels are basically a way of taking sulphur out of coal, but this gets to be a very costly exercise, and so in looking at these environmental constraints, we have got to be very careful that we appreciate the costs that they are forcing on the consumer and whether they are justified, and of the ways of moderating that cost. For instance, 90 percent of the reduction may be achievable at a reasonable cost and the next 5 percent at a completely unacceptable cost. If that is so, and generally it is so, we have got to determine where those cutoff levels are.

Chairman REUSS. Mr. King, Mr. Branson, Mr. Lichtblau, and Mr. Steele, thank you very much for some absolutely invaluable testimony. We appreciate your helping us, and we are most grateful.

The subcommittee will now stand in adjournment.

[Whereupon, at 11:35 a.m., the subcommittee adjourned, subject to the call of the Chair.]

APPENDIX

The Secretary of State

Speech

February 3, 1975
Washington, D.C.

Bureau of Public Affairs
Office of Media Services

ENERGY: THE NECESSITY OF DECISION

Address by Secretary of State Henry A. Kissinger before the National Press Club

Ladies and Gentlemen:

I appreciate this opportunity to speak to you on the question of energy.

The subject is timely, for this week marks an important moment in both our national and international response to the energy crisis.

On Wednesday, the Governing Board of the International Energy Agency [IEA] convenes in Paris for its monthly meeting. This organization, which grew out of the Washington Energy Conference, represents one of the major success stories of cooperation among the industrialized democracies in the past decade. In recent months it has begun to mobilize and coordinate the efforts of the industrial democracies in energy conservation, research, and development of new energy sources. The IEA already has put in place many of the building blocks of a coordinated energy policy. At the forthcoming meeting, the United States will advance comprehensive proposals for collective action, with special emphasis on the development of new energy sources and the preparation of a consumer position for the forthcoming dialogue with the producers.

Equally important, we are now engaged in a vital national debate on the purposes and requirements of our national energy program. Critical decisions will soon be made by the Congress—decisions that will vitally affect other nations as well as ourselves.

The Nature of the Challenge

The international and national dimensions of the energy crisis are crucially linked. What happens with respect to international energy policy will have a fundamental effect on the economic health of this nation. And the international economic and energy crisis cannot be solved without purposeful action and leadership by the United States. Domestic and international programs are inextricably linked.

The energy crisis burst upon our consciousness because of sudden, unsuspected events. But its elements have been developing gradually for the better part of two decades.

In 1950, the United States was virtually self-sufficient in oil. In 1960, our reliance on foreign oil had grown to 16 percent of our requirements. In 1973, it had reached 35 percent. If this trend is allowed to continue, the 1980's will see us dependent on imported oil for fully half of our needs. The impact on our lives will be revolutionary.

This slow but inexorable march toward dependency was suddenly intensified in 1973 by an oil embargo and price increases of 400 percent in less than a single year. These actions—largely the result of political decisions—created an immediate economic crisis, both in this country and around the world. A reduction of only 10 percent of the imported oil, lasting less than half a year, cost Americans half a million jobs and over one percent of national output; it added at least 5 percentage points to the price index, contributing to our worst inflation since World War II; it set the stage for a serious recession; and it expanded the oil income of the OPEC nations from $23 billion in 1973 to a current annual rate of $110 billion, thereby effecting one of the greatest and most sudden transfers of wealth in history.

The impact on other countries much more dependent on oil imports has been correspondingly greater. In all industrial countries economic and political difficulties that had already reached the margin of the ability of governments to manage have threatened to get out of control.

Have we learned nothing from the past year? If we permit our oil consumption to grow without restraint, the vulnerability of our economy to external disruptions will be grossly magnified. And this vulnerability will increase with every passing year. Unless strong, corrective steps are taken, a future embargo would have a devastating impact on American jobs and production. More than 10 percent of national employment and output, as well as a central element of the price structure of the American economy, would be subject to external decisions over which our national policy can have little influence.

As we learned grimly in the 1920's and 30's, profound political consequences inevitably flow from massive economic dislocations. Economic distress fuels social and political turmoil; it erodes the confidence of the people in democratic government and the confidence of nations in international harmony. It is fertile ground for conflict, both domestic and international.

> "In 1950, the United States was virtually self-sufficient in oil. In 1960, our reliance on foreign oil had grown to 16 percent of our requirements. In 1973, it had reached 35 percent."

The situation is not yet so grave, but it threatens to become so. The entire industrialized world faces at the same time a major crisis of the economy, of the body politic, and of the moral fiber. We and our partners are being tested—not only to show our technical mastery of the problems of energy, but even more importantly to show if we can act with foresight to regain control of our future.

For underlying all difficulties, and compounding them, is a crisis of the spirit—the despair of men and nations that they have lost control over their destiny. Forces seem loose beyond the power of government and society to manage.

In a sense we in America are fortunate that political decisions brought the energy problem to a head before economic trends had made our vulnerability irreversible. Had we continued to drift, we would eventually have found ourselves swept up by forces much more awesome than those we face today.

As it is, the energy crisis is still soluble. Of all nations, the United States is most affected by the sudden shift from near self-sufficiency to severe dependence on imported energy. But it is also in the best position to meet the challenge. A major effort now—of conservation, of technological innovation, of international collaboration—can shape a different future for us and for the other countries of the world. A demonstration of American resolve now will have a decisive effect in leading other industrial nations to work together to reverse present trends toward dependency. Today's apparently pervasive crisis can in retrospect prove to have been the beginning of a new period of creativity and cooperation.

One of our highest national priorities must be to reduce our vulnerability to supply interruption and price manipulation. But no one country can solve the problem alone. Unless we pool our risks and fortify the international financial system, balance-of-payments crises will leave all economies exposed to financial disruption. Unless all consuming nations act in parallel to reduce energy consumption through conservation and to develop new sources of supply, the efforts of any one nation will prove futile—the price structure of oil will not be reformed and the collective economic burden will grow. And unless consumers concert their views, the dialogue with the producers will not prove fruitful.

The actions which the United States takes now are central to any hope for a global solution. The volume of our consumption, and its potential growth, is so great that a determined national conservation program is essential. Without the application of American technology and American enterprise, the rapid development of significant new supplies and alternative sources of energy will be impossible.

There is no escape. The producers may find it in their interest to ease temporarily our burdens. But the price will be greater dependence and greater agony a few years from now. Either we tackle our challenge immediately or we will confront it again and again in increasingly unfavorable circumstances in the years to come. If it is not dealt with by this Administration, an even worse crisis will be faced by the next—and with even more anguishing choices.

History has given us a great opportunity disguised as a crisis. A determined energy policy will not only ease immediate difficulties, it will help restore the international economy, the vitality of all the major industrial democracies, and the hopes of mankind for a just and prosperous world.

The Strategy of Energy Cooperation

We and our partners in the International Energy Agency have been, for a year, pursuing strategy in three phases:

- The first phase is to protect against emergencies. We must be prepared to deter the use of oil or petrodollars as political weapons and, if that fails, we must have put ourselves in the best possible defensive position. To do this, we have established emergency sharing programs to cope with new embargoes, and created new mechanisms to protect our financial institutions against disruption. This stage of our common strategy is well on the way to accomplishment.
- The second phase is to transform the market conditions for OPEC oil. If we act decisively to reduce our consumption of imported oil and develop alternative sources, pressure on prices will increase. Measures to achieve this objective are now before the International Energy Agency or national parliaments; we expect to reach important agreements on them before the end of March.
- Once the consumer nations have taken these essential steps to reduce their vulnerability, we will move to the third stage of our strategy—to meet with the producers to discuss an equitable price, market structure, and long-term economic relationship. Assuming the building blocks of consumer solidarity are in place, we look toward a preparatory meeting for a producer-consumer conference before the end of March.

Our actions in all these areas are interrelated. It is not possible to pick and choose; since they are mutually reinforcing, they are essential to each other. No emergency program can avail if each year the collective dependence on OPEC oil increases. New sources of energy, however vast the investment program, will be ineffective unless strict measures are taken to halt the runaway, wasteful growth in consumption. Unless the industrial nations demonstrate the political will to act effectively in all areas, the producers will be further tempted to take advantage of our vulnerability.

In recent months we and our partners have taken important steps to implement our overall strategy. Two safety nets against emergencies have been put in place. In November, the IEA established an unprecedented plan for mutual assistance in the event of a new embargo. Each participating nation is committed to build an emergency stock of oil. In case of embargo, each nation will cut its consumption by the same percentage, and available oil will be shared. An embargo against one will become an embargo against all.

> "A major effort now—of conservations, of technological innovation, of international collaboration—can shape a different future for us and for the other countries of the world. A demonstration of American resolve now will have a decisive effect in leading other industrial nations to work together to reverse present trends toward dependency."

And in January, the major industrial nations decided to create a $25 billion solidarity fund for mutual support in financial crises—less than 2 months after it was first proposed by the United States. This mutual insurance fund will furnish loans and guarantees to those hardest hit by payments deficits, thus safeguarding the international economy against shifts, withdrawals, or cutoffs of funds by the producers.

The next steps should be to accelerate our efforts in the conservation and development of new energy sources. Action in these areas, taken collectively, will exert powerful pressures on the inflated price. No cartel is so insulated from economic conditions that its price structure is invulnerable to a transformation of the market. Because of the reduced consumption in the past year, OPEC has already shut down a fourth of its capacity, equaling 9 million barrels a day, in order to keep the price constant. New oil exploration, accelerated by the fivefold-higher price, is constantly discovering vast new reserves outside of OPEC. The $10 billion in new energy research

in the United States—on the scale of the Manhattan Project and the moon-landing program—is certain to produce new breakthroughs sooner or later.

As the industrialized nations reduce consumption and increase their supply, it will become increasingly difficult for OPEC to allocate the further production cuts that will be required among its members. Even now, some OPEC members are shaving prices to keep up their revenue and their share of the market. Indeed, it is not too soon in this decade of energy shortages to plan for the possibility of energy surpluses in the 1980's.

The strategy we have been pursuing with our partners since the Washington Energy Conference has linked our domestic and international energy policies into a coherent whole. We have made remarkable progress, but much remains to be done. The question now is whether the industrialized countries have the will to sustain and reinforce these promising initiatives. Conservation and the development of new sources of energy are the next priorities on our common agenda.

Conservation

Unconstrained consumption of cheap oil is the principal cause of the present vulnerability of the industrial countries. Neither the United States nor other consumers can possibly reduce their dependence on imports until they reverse the normal—which is to say wasteful—growth of consumption.

There is simply no substitute for conservation. Alternative energy supplies will not be available for 5 or 10 years. In the next few years conservation, and only conservation, will enable us both to absorb the present burden of high energy costs and to begin to restore the balance of consumer-producer relations.

Only a determined program of conservation can demonstrate that we and our partners have the will to resist pressures. If the industrialized nations are unwilling to make the relatively minor sacrifices involved in conservation, then the credibility of all our other efforts and defensive measures is called into the question.

Some say we face a choice between conservation and restoring economic growth. The contrary is true. Only by overcoming exorbitant international energy costs can we achieve reliable long-term growth. If we doom ourselves to 50 percent dependence on imported energy, with the supply and price of a central element of our economy subject to external manipulation, there is no way we can be sure of restoring and sustaining our jobs and growth. These decisions will depend on foreign countries for whom our prosperity is not necessarily a compelling objective.

To be sure, conservation—by any method—will have an economic cost. The restructuring which it entails, away from production and consumption of energy-intensive goods, incurs shortrun dislocations. At a time of recession, this must concern us. Yet these costs are small compared to what will be exacted from us if we do not act. Without conservation, we will perpetuate the vulnerability of our economy and our national policy. And we will perpetuate as well the excessive international energy prices which are at the heart of the problem.

"Some say we face a choice between conservation and restoring economic growth. The contrary is true. Only by overcoming exorbitant international energy costs can we achieve reliable long-term growth."

At present, the United States—in the midst of recession—is importing 6.7 million barrels of oil a day. When our economy returns to full capacity that figure will rise; by 1977 it will be 8 or 9 million barrels a day in the absence of conservation. Imports will continue to grow thereafter. Even with new production in Alaska and the outer continental shelf, this import gap will remain if we do not reduce consumption significantly and rapidly.

With these prospects in mind, President Ford has set the goal of saving a million barrels a day of imports by the end of this year and 2 million by 1977. That amounts to the increase in dependence that would occur as the economy expands again, in the absence of a conservation program.

Our conservation efforts will be powerfully reinforced by the actions of our IEA partners and of other interested countries such as France. Their collective oil consumption equals ours, and they are prepared to join with us in a concerted program of conservation; indeed some of them have already instituted their own conservation measures. But any one country's efforts will be

nullified unless they are complemented by other consumers. This is why the United States has proposed to its IEA partners that they match our respective conservation targets. Together we can save 2 million barrels a day this year; and at least 4 million barrels in 1977.

If these goals are reached, under current economic conditions OPEC will have to reduce its production further; even when full employment returns, OPEC will have surplus capacity. More reductions will be hard to distribute on top of the existing cutbacks of 9 million barrels a day. As a result, pressures to increase production or to lower prices will build up as ambitious defense and development programs get under way. By 1977 some oil producers will have a payments deficit; competition between them for the available market will intensify. The cartel's power to impose an embargo and to use price as a weapon will be greatly diminished.

> "In short, the massive development of alternative sources by the industrial countries will confront OPEC with a choice: they can accept a significant price reduction now in return for stability over a longer period; or they can run the risk of a dramatic break in prices when the program of alternative sources begins to pay off."

But if America—the least vulnerable and most profligate consumer—will not act, neither will anyone else. Just as our action will have a multiplier effect, so will our inaction stifle the efforts of others. Instead of reducing our collective imports, we will have increased them by 2-4 million barrels a day. OPEC's ability to raise prices, which is now in question, will be restored. In exchange for a brief respite of a year or two, we will have increased the industrialized world's vulnerability to a new and crippling blow from the producers. And when that vulnerability is exposed to public view through a new embargo or further price rises, the American people will be entitled to ask why their leaders failed to take the measures they could have when they should have.

One embargo—and one economic crisis—should be enough to underline the implications of dependency.

The Importance of New Supplies

Conservation measures alone, crucial as they are, cannot permanently reduce our dependence on imported oil. To eliminate dependence over the long term we must accelerate the development of alternative sources of energy. This will involve a massive and complex task. But for the country which broke the secret of fission in 5 years and landed men on the moon in 8 years, the challenge should be exciting. The Administration is prepared to invest in this enterprise on a scale commensurate with those previous pioneering efforts; we are ready as well to share the results with our IEA partners on an equitable basis.

Many of the industrialized countries are blessed with major energy reserves which have not yet been developed—North Sea oil, German coal, coal and oil deposits in the United States, and nuclear power in all countries. We have the technical skill and resources to create synthetic fuels from shale oil, tar sands, coal gasification and liquefaction. And much work has already been done on such advanced energy sources as breeder reactors, fusion, and solar power.

The cumulative effort will of necessity be gigantic. The United States alone shall seek to generate capital investments in energy of $500 billion over the next 10 years. The Federal Government will by itself invest $10 billion in research into alternative energy sources over the next 5 years, a figure likely to be doubled when private investment in research is included.

But if this effort is to succeed, we must act now to deal with two major problems—the expense of new energy sources and the varying capacities of the industrialized countries.

New energy sources will cost considerably more than we paid for energy in 1973 and can never compete with the production costs of Middle Eastern oil.

This disparity in cost poses a dilemma. If the industrial countries succeed in developing alternative sources on a large scale, the demand for OPEC oil will fall, and international prices may be sharply reduced. Inexpensive imported oil could then jeopardize the investment made in the alternative sources; the lower oil prices would also restimulate demand, starting again the cycle of rising imports, increased dependence, and vulnerability.

Thus paradoxically, in order to protect the major investments in the industrialized countries that are needed to bring the international oil prices down, we must insure that the price for

oil on the domestic market does not fall below a certain level.

The United States will therefore make the following proposal to the International Energy Agency this Wednesday:

In order to bring about adequate investment in the development of conventional nuclear and fossil energy sources, the major oil importing nations should agree that they will not allow imported oil to be sold domestically at prices which would make those new sources noncompetitive.

This objective could be achieved in either of two ways. The consumer nations could agree to establish a common floor price for imports, to be implemented by each country through methods of its own choosing such as import tariffs, variable levies, or quotas. Each country would thus be free to obtain balance-of-payments and tax benefits, without restimulating consumption, if the international price falls below agreed levels. Alternatively, IEA nations could establish a common IEA tariff on oil imports. Such a tariff could be set at moderate levels and phased in gradually as the need arises.

> "Collective actions to restore balance to the international economic structure... will contribute enormously to the likelihood of the success of the projected consumer-producer dialogue."

President Ford is seeking legislation requiring the executive branch to use a floor price or other appropriate measures to achieve price levels necessary for our national self-sufficiency goals.

Intensive technical study would be needed to determine the appropriate level at which prices should be protected. We expect that they will be considerably below the current world oil prices. They must, however, be high enough to encourage the long-range development of alternative energy sources.

These protected prices would in turn be a point of reference for an eventual consumer-producer agreement. To the extent that OPEC's current high prices are caused by fear of precipitate later declines, the consuming countries, in return for an assured supply, should be prepared to offer producers an assured price for some definite period so long as this price is substantially lower than the current price.

In short, the massive development of alternative sources by the industrial countries will confront OPEC with a choice: they can accept a significant price reduction now in return for stability over a longer period; or they can run the risk of a dramatic break in prices when the program of alternative sources begins to pay off. The longer OPEC waits, the stronger our bargaining position becomes.

The second problem is that the capacities of the industrialized countries to develop new energy sources vary widely. Some have rich untapped deposits of fossil fuels. Some have industrial skills and advanced technology. Some have capital. Few have all three.

Each of these elements will be in great demand, and ways must be found to pool them effectively. The consumers, therefore, have an interest in participating in each other's energy development programs.

Therefore, the United States will propose to the IEA this Wednesday the creation of a synthetic fuels consortium within IEA. Such a body would enable countries willing to provide technology and capital to participate in each other's synthetic energy projects. The United States is committed to develop a national synthetic fuel capacity of one million barrels a day by 1985; other countries will establish their own programs. These programs should be coordinated, and IEA members should have an opportunity to share in the results by participating in the investment. Qualifying participants would have access to the production of the synthetics program in proportion to their investment.

In addition, the United States will propose the creation of an energy research and development consortium within IEA. Its primary task will be to encourage, coordinate, and pool large-scale national research efforts in fields—like fusion and solar power—where the costs in capital equipment and skilled manpower are very great, the lead times very long, but the ultimate payoff in low-cost energy potentially enormous.

The consortium also would intensify the comprehensive program of information exchange which—with respect to coal, nuclear technology, solar energy, and fusion—has already begun within the IEA. We are prepared to earmark a substantial proportion of our own research and development resources for cooperative efforts with other IEA countries which are willing to contribute. Pooling the intellectual effort of the great indus-

trial democracies is bound to produce dramatic results.

When all these measures are implemented, what started as crisis will have been transformed into opportunity; the near panic of a year ago will have been transformed into hope; vulnerability will have been transformed into strength.

The Mutual Interests of Consumers and Producers

Consumer solidarity is not an end in itself. In an interdependent world, our hopes for prosperity and stability rest ultimately on a cooperative long-term relationship between consumers and producers.

This has always been our objective. It is precisely because we wish that dialogue to be substantive and constructive that we have insisted that consumers first put their own house in order. Collective actions to restore balance to the international economic structure, and the development in advance of common consumer views on the agenda, will contribute enormously to the likelihood of the success of the projected consumer-producer dialogue. Without these measures, discussions will only find us restating our divisions, and tempt some to seek unilateral advantages at the expense of their partners. The result will be confusion, demoralization, and inequity, rather than a just reconciliation between the two sides.

> "The producers seek a better life for their peoples and a future free from dependence on a single depleting resource; the industrialized nations seek to preserve the hard-earned economic and social progress of centuries; the poorer nations seek desperately to resume their advance toward a more hopeful existence."

A conciliatory solution with the producers is imperative for there is no rational alternative. The destinies of all countries are linked to the health of the world economy. The producers seek a better life for their peoples and a future free from dependence on a single depleting resource; the industrialized nations seek to preserve the hard-earned economic and social progress of centuries; the poorer nations seek desperately to resume their advance toward a more hopeful existence. The legitimate claims of producers and consumers, developed and developing countries, can and must be reconciled in a new equilibrium of interest and mutual benefit.

We must begin from the premise that we can neither return to past conditions nor tolerate present ones indefinitely. Before 1973, market conditions were often unfair to the producers. Today they are unbearable for the consumers; they threaten the very fabric of the international economic system on which, in the last analysis, the producers are as dependent for their well-being as the consumers.

As the consumers approach their preparatory meeting with the producers, what are the basic principles that should guide them?

The United States will propose the following approach to its partners in the IEA:

First, we should explore cooperative consumer-producer action to recycle the huge financial surpluses now accumulating. The oil producers understand that these new assets—which are far greater than they can absorb—may require new management mechanisms. At the same time, the industrial nations know that the stability of the global economic structure requires the constructive participation of the producers.

Second, and closely related to this, is the need to examine our internal investment policies. The oil producers need productive outlets for their revenues; the industrial democracies, while they should welcome new investment, will want to retain control of essential sectors of their economies. These needs can be reconciled through discussion and agreement between consumers and producers.

Third, we must help the producer nations find productive use for their wealth in their own development and to reduce their dependence on a depleting resource. New industries can be established, combining the technology of the industrialized world with the energy and capital of the producers, for their own benefit and that of the poorer nations. The creation of fertilizer and petrochemical plants is among the more promising possibilities.

Fourth, the oil-producing countries and the industrial consuming countries share a responsibility to ease the plight of the poorest nations, whose economies have been devastated by OPEC's price increases. Technology and capital must be combined in an international effort to assist those most seriously affected by the current economic crisis.

Fifth is the need to provide consumers with a secure source of supply. Another attempt to use oil as a weapon would gravely threaten the economies of the industrial nations and destroy the possibilities of consumer-producer cooperation. Oil-sharing arrangements by the consumers would blunt its impact at first, but over time an atmosphere of confrontation would be inevitable. Thus, if the producer-consumer dialogue is to be meaningful, understandings on long-term supplies are essential.

A central issue, of course, will be price. It is vital to agree on prices for the long run which will satisfy the needs of consumers and producers alike. The balance-of-payments crisis of the consumers must be eased; at the same time, the producers are entitled to know that they can count on a reasonable level of income over a period of time.

The United States is ready to begin consultations with the other major consuming nations on this agenda. We will be prepared to expand on these proposals, and will welcome the suggestions of our friends, so that we can fashion together a common and positive program.

In sum, consumers and producers are at a crossroads. We have the opportunity to forge new political and institutional relationships, or we can go our separate ways, each paying the price for our inability to take the long view. Mutual interest should bring us closer together; only selfishness can keep us apart. The American approach will be conciliatory.

The implications for the structure of world politics are profound. If we act with statesmanship we can shape a new relationship between consumer and producer, between developed and developing nations, that will mark the last quarter of the 20th century as the beginning of the first truly global, truly cooperative international community.

The Need for United Action

The United States will soon celebrate the 200th anniversary of its independence. In those 200 years Americans have gloried in freedom, used the blessings of nature productively, and jealously guarded our right to determine our fate. In so doing, we have become the most powerful nation on earth and a symbol of hope to those who yearn for progress and value justice. Yet now we sometimes seem uncertain of our future, disturbed by our recent past, and confused as to our purpose.

But we must persevere, for we have no other choice. Either we lead, or no one leads; either we succeed, or the world will pay for our failure.

The energy challenge is international; it can only be met by the cooperative actions of all the industrial democracies. We are far advanced with our partners toward turning a major challenge into bold creation and determined response.

But our hopes for the future rest heavily on the decisions we take on our own domestic energy program in the days and weeks ahead. Our example—for good or ill—will chart the course for more than ourselves alone. If we hesitate or delay, so will our partners. Undoing measures already instituted, without putting an alternative program in their place, will have implications far transcending the immediate debate.

> "The energy challenge is international; it can only be met by the cooperative actions of all the industrial democracies."

The United States bears world responsibility not simply from a sense of altruism or abstract devotion to the common good—although those are attributes hardly deserving of apology. We bear it, as well, because we recognize that America's jobs and prosperity—and our hopes for a better future—decisively depend upon a national effort to fashion a unified effort with our partners abroad. Together we can retain control over our affairs and build a new international structure with the producers. Apart we are hostages to fate.

A domestic program that will protect our independence; a cooperative program with other consumers; and accommodation with producers—these are the indispensable and inseparable steps toward a new equilibrium of interest and justice. No one step can succeed in the absence of the other two.

It is the glory of our nation that, when challenged, we have always stepped forward with spirit and a will to dare great things. It is now time to do so again, and in so doing to reaffirm to ourselves and to the world that this generation of Americans has the integrity of character to carry on the noble experiment that began 2 centuries ago.

THE CHAIRMAN [William Broom, president of the National Press Club]: Thank you, Mr. Secretary.

Mr. Secretary, in November you, the Secretary of the Treasury, and Mr. Arthur Burns, the Chairman of the Federal Reserve Board, all made speeches emphasizing the imperative need to bring about a lowering of the OPEC prices of oil. Now the Administration is advocating an energy policy based upon a price even higher than the OPEC price. What happened between November and now?

SECRETARY KISSINGER: I do not think it is correct to say that the Administration's energy policy is based on an increase in price. The Administration's energy policy attempts to reduce consumption. The increase in price that is designed to reduce consumption will be rebated to the American public so that the inflationary impact will be severely minimized, if not eliminated. So we are not dealing here with an increase in price that produces a balance-of-payments drain. We are dealing with a technical measure designed to reduce consumption for the reasons that I have explained, and the increase will then be rebated in various ways to the American people.

Q: Our audience has many questions for you today, Mr. Secretary. A second one here concerns what you anticipate from our Allies. The first questioner asks—what result might you foresee if IEA nations do not all agree on some method of establishing floor prices; specifically, what results if only the U.S.A. does so. And secondly, someone wonders if you can identify or expect any European country or any consuming nation not to act in parallel in the consumer bloc.

A: The proposal about a floor price will, of course, only be formally submitted to our Allies on Wednesday. But we have had some exploratory conversations which lead us to believe that the proposal will receive a sympathetic reception. The United States is, of course, in a position to establish such a price for itself, and given the scale of its investment, it could carry out a very massive program for the development of alternative energy sources. But in order to achieve the objectives which I have described, the cooperation of all the consumers would be extremely important.

I would not want to identify—indeed, I do not know any consumers that are likely to disagree. I believe that the cooperation of the nations in IEA, as I pointed out in my speech, has been one of the great success stories of the last decade-and-a-half. Within the space of less than a year, very major steps have been taken in the field of conservation, in the field of emergency sharing, and in the field of financial solidarity. And I have every confidence that the spirit of cooperation that has brought us to this point will hold in the months ahead.

Q: A number of questions on price. What do you estimate the protected price of oil will be? For how long will it be protected? How will the long-term protected price be affected by inflation? And based on your remarks, what do you believe is the minimum price per barrel for domestic oil that will be required to keep U.S. investments competitive?

A: Well, the precise price would have to be established first by more detailed technical studies, and then in consultation with our partners that also have an interest in the problem. However, it can be stated now that the protected price would be substantially below the existing world price. It would have to be protected for a period of time sufficient to justify the massive investment in the alternative sources that are called for.

With respect to the impact of inflation on the protected price, if a long-term price arrangement were made with the producers and if the price were pegged at a level considerably below current world prices, the United States would not exclude discussing indexing in relation to it.

Q: If the cost of oil in the United States and in the major industrial nations remains above the level of exported oil, or Communist country prices, how are U.S. or European exporters of petrochemicals going to cope with competition from Eastern European or other nations?

A: Well, this assumes that there is an unlimited capacity by the Soviet Union to expand its oil exports at lower prices; and we doubt seriously that this capacity exists.

Q: Have you had any reaction as yet from the oil-producing countries' leaders regarding President Ford's plan to impose the import levy on oil in this country? What is the possibility that the oil-producing countries will use that as a reason for a further price increase?

A: We have not had any reaction from the oil-producing countries with respect to the President's import tax. I believe also that the oil producers very clearly understand the difference between a price increase that compounds a balance-of-payments deficit and a price increase that is

rebated to the consumers.

Q: Do you agree, Mr. Secretary, with Senator Church's proposal that the United States set up an oil-purchasing agency as one way of eliminating unnecessary competition for profits and supplies?

A: I have frankly not had an opportunity to study this proposal in great detail, and I therefore would rather withhold judgment.

Q: An enterprising member of the audience asks—can we trade U.S. wheat for Russian oil?

A: That, too, is something I would like to examine a little bit. [Laughter and applause.]

Q: We have a number of questions on other countries, particularly the Middle East, where you will be going within a very short space of time. Will it be possible to arrange a further military disengagement on the Sinai with Egypt without further progress with Syria on the Golan Heights? And secondly, will the time come when the United States will have to deal with the Palestine Liberation Organization [PLO]?

A: If I didn't believe that there was some possibility of progress in further negotiations, I would not obviously go to the Middle East. Of course any step that is taken should only be considered as an interim step toward a final peace. And all other of the nations in the Middle East will have to participate in that next step—or will have to participate not in the forthcoming step, but will have to participate in a negotiation for a final peace.

With respect to the PLO, we have stated our position repeatedly, that there is no possibility of a negotiation as long as the PLO does not recognize the existence of Israel.

Q: How do you explain shipments of American airplanes to the Middle East and to the Arab countries in view of the possibility of the renewal of an Arab embargo on oil?

A: In my press conference last week, I explained the American policy with respect to arms shipments to other countries as follows: The questions that have to be answered are whether a threat to the security of these countries exists in the minds of these countries; whether the United States considers this a realistic appraisal; whether the United States has an interest in the stability and security of the countries concerned; and finally, whether, if the United States does not supply these weapons, these countries would remain without weapons. In the case of the arms shipments to which the United States has agreed, we believe that the answer to each question can be affirmative—and in view of the various balance-of-payments considerations that I have earlier outlined, also in our interest. But the controlling decision is not a commercial one. The controlling decision is the political one that I explained.

Q: Four or five questions on Cuba. The first one asks whether you have any comment on Senator Sparkman's recent remarks about resuming U.S. relations with Cuba and what are the chances that U.S. policy towards Cuba will change this year.

A: I'm brave but not reckless. [Laughter.]

In the spirit of partnership between the Congress and the Executive that I called for recently, I would like to say that we are examining our policy toward Cuba—that we are prepared to look at various of the measures that have been taken in the inter-American system with a view toward seeing what can be done in our Cuban relationship.

Q: Do you see any possibility, Mr. Secretary, of an opportunity for the United States to sell some goods to Cuba in the near future to help us with our balance of payments?

A: Whatever decision will be made on Cuba is not going to be dictated by economic considerations. It will grow out of our assessment in the international context, as well as our overall relationships with the Western Hemisphere.

Q: Let's switch to the Eastern Hemisphere for a moment. A member of the audience notes that Chinese leaders are reportedly dissatisfied at the pace of Sino-American rapprochement. When will the United States recognize mainland China? Will it be during President Ford's visit to China this year? And, presuming, when will we withdraw U.S. troops from Taiwan?

A: I read these accounts with great interest, but of course we can only deal with the expressions that the Chinese leaders make to American officials. And we do not have the impression that the Chinese leaders are dissatisfied with the state of Chinese-American relations. We are committed in the Shanghai communique to proceed toward the normalization of relations with the People's Republic of China. We are determined to carry out not only the letter but the spirit of the Shanghai communique; and we will base our improving relations with the People's Republic of China on these principles.

Q: Within a few days, the Prime Minister of Pakistan will be paying a visit to Washington. Is the United States ready to lift the embargo on

arms to Pakistan when Prime Minister Bhutto is here this week?

A: The question about Pakistan, an ally which is in the curious position of being subject to American embargo, is always before us—especially at a time when the Prime Minister of Pakistan visits the United States. No decisions have yet been made, and I doubt that any final decision will be made while Prime Minister Bhutto is here. But of course it is always a subject that is seriously examined in preparation for his visit and of course will be discussed.

Q: A pair of questions on Viet-Nam. Is the division of South Viet-Nam into Government and Viet Cong regions a feasible way to stop the fighting? Or—to put it another way—another questioner asks: Despite any agreements that have been made or will be made, do you feel there can be peace in Viet-Nam as long as North Vietnamese troops occupy any part of South Viet-Nam?

A: The United States has always been prepared, together with the Government in Saigon, to see to it that peace is maintained in South Viet-Nam along the demarcation lines that existed when the armistice agreement was signed. It is the Communist side which has consistently refused to agree to a demarcation and to deploy the international control teams by which such a demarcation would be insured.

Under the agreement in January 1973, there was no requirement for the withdrawal of the North Vietnamese troops which were then in South Viet-Nam. But there was a flat prohibition against any further increase in their numbers—or, indeed, a flat prohibition against sending any new personnel. This prohibition has been consistently violated from the very first day of the agreement. And the only security problem in South Viet-Nam is the presence of North Vietnamese military forces.

Q: Back to the Western Hemisphere. Today's Washington Post reported some conclusions by former Chilean Ambassador Orlando Letelier, who alleged that he had been deceived about CIA involvement with the opposition to the Allende government. In retrospect, should any of the CIA's activities have been different—do you regret the outcome?

A: I found it amazing that the front page of a leading newspaper would report a totally unsupported story by an individual who, after all, was not exactly disinterested and who told a rather amazing tale that he had been invited to the house of a Washington columnist to receive a special message from me.

Now, it would be an interesting question—who exactly passed that message to him that he should come to the house of that columnist. That columnist does not remember such an incident; I do not remember such an incident. And while our denial was duly reported in the last paragraph of the story, one would not be able to determine that from the front page of an article that can only be designed to prove that I was telling a lie for purposes that are totally unclear by a man who has a profound interest in the problem. And I might say I find it particularly painful because I have not been uninvolved in his release from prison in Chile. [Applause.]

Q: A pair of questions here about food as it relates to the present energy crisis. One questioner wants to know if there is a plan to use food as a weapon in the strategy of the consuming nations against the oil-producing countries.

A: In my first public statement as Secretary of State, two days after I was sworn in, I proposed the convening of a World Food Conference. I did so because it seemed to me that if we were serious about our assertions that the world was interdependent and that a new world order had to be instituted based on this principle, then we had a moral and political obligation to use the resource which we have in surplus for the benefit of all of mankind. We made proposals at the World Food Conference which were designed to alleviate the chronic food shortage that exists all over the world; and we emphasized that whatever the level of American food aid, we would not be able to deal with the chronic problem by American food alone—that it was necessary to increase the productivity, especially in less developed countries, to improve the distribution, and to take other fundamental measures of agricultural reform, to which the United States will contribute.

With respect to American food aid, which is a separate problem, a very large percentage of this food aid is given for primarily humanitarian purposes. There are, of course, countries where we are conscious that this food aid also helps us politically, and we have no reason to apologize for this. But even in those countries there is a profound need for food.

We have worked closely with Senator [Hubert H.] Humphrey, with Senator [Mark O.] Hatfield—first, to produce the maximum level of food aid

that was possible and, secondly, to allocate it in a manner that met both the humanitarian and other needs of this country.

Q: In that connection, Mr. Secretary, in the final moments of drafting the budget, $178 million was apparently added to the total available for the P.L. 480 Food for Peace program. Some people are crediting you with arguing for the addition of that $178 million. Who is going to receive it? How much of the total food aid available will go to most seriously affected [MSA] countries? Have Cambodia and South Viet-Nam been added to the MSA list?

A: I can hardly keep up with the newspaper reports printing the breakdown of various working papers with respect to food aid, none more recent, incidentally, than 2 months. I frankly don't know the exact figure that was added in recent weeks to the budget. But, again, if you remember—I don't know why I assume that each of you remember every detail of every speech I gave; I look at my staff here and they have to open staff meetings by rehearsing them, in spite of their prayers. [Laughter.]

But in that speech I indicated that the United States would support the highest possible level of food aid. The only reason we did not announce the level then was because of the impact on American domestic prices and because we were afraid that if the result of announcing a high level of food aid would be to push up the American domestic food prices, that then congressional support for the food aid program might evaporate altogether. Therefore we have consistently been at the highest level that was compatible with our domestic price structure.

Now that the recent crop reports have indicated that we have adequate food supplies, we have, as a matter of course, gone to the high levels. And it is not the case that this was suddenly jury-rigged in order to produce a particular effect. With respect to the allocations required by the Congress between the humanitarian and other purposes, we have worked out this arrangement with all the Senators and Congressmen who have shown a particular interest in the problem.

To answer your specific question, Viet-Nam and Cambodia have not been added to the MSA list, even though, in fairness, the only reason they are not on the MSA list of the United Nations is because Viet-Nam is not in the United Nations.

THE CHAIRMAN: Thank you very much.

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ENCOURAGING INVESTMENT IN DOMESTIC ENERGY: MINIMUM SAFEGUARD PRICE

The following information, primarily in question-and-answer form, provides the rationale for the program to establish a common safeguard price for the domestic sale of imported oil.

On March 20, 1975, the United States and the other 17 members of the International Energy Agency (IEA) agreed in principle on a cooperative program to accelerate the development of new energy supplies. A common minimum safeguard price, or "floor" price, is a key element of the program.

The basic purpose of this IEA cooperative program is threefold:

- To reduce dependence on unreliable sources of oil by increasing the supply of energy under our control. (In 1950 the United States was virtually self-sufficient in oil. Today we import about 36 percent of the oil we consume.)
- To bring down the present exorbitant price of imported oil by increasing supply from non-OPEC sources. (OPEC accounts for almost 70 percent of free-world productive capacity and is able to maintain the price of oil by limiting supply.)
- To assure that the United States is not at a competitive disadvantage when the world price of oil breaks.

The IEA cooperative program to accelerate development of new energy supplies has three major elements: Encouraging and safeguarding investment in conventional nuclear and fossil (oil, coal, gas) energy sources by not allowing imported oil to be sold within IEA countries below a common minimum price; promoting joint development of synthetic fuel and other forms of energy that involve large capital and development costs; and cooperating in joint research and development projects in the more exotic forms of energy, such as coal liquefaction and solar energy.

Q: Is there really any need for a special governmental program to stimulate supply? Isn't the high price of oil a sufficient stimulus? World consumption is down, there have been new discoveries of oil, and no one is waiting in line at gas stations. Why not let market forces take care of the problem?

A: It is true that current high prices stimulate investment and deter consumption. (Today's lower

> The common minimum safeguard price, or "floor" price, for the domestic sale of imported oil will:
>
> - Reduce our dependence on imported petroleum by encouraging domestic energy investment;
> - Contribute to a reduction in the world price of oil;
> - Prevent a resurgence of demand when the world price does break;
> - Permit our economy to reap the full income and balance-of-payments benefits of a fall in the world price;
> - Maintain the competitiveness of U.S. industry in world markets; and
> - Require no government expenditure or loss of revenue.

consumption and the present glut of oil are due in considerable part to the temporary worldwide recession and an abnormally warm winter.) But consuming countries cannot rely on market forces alone.

- If we are passive in the face of the fourfold increase in price, OPEC could be emboldened to increase prices further. The result would be a further drain on consumer purchasing power, a further spur to inflation, deeper balance-of-payments and budgetary deficits, the further impoverishment of the poor, and a threat to the world economic system.
- The longer we continue to depend on unreliable sources for so much of our oil, the more we leave ourselves open to possible supply interruptions. Oil has been used once as a political weapon. It can be used again. The embargo in 1973 cost us about 500,000 jobs and $10-20 billion in lost output. Moreover, most of OPEC oil comes from the Middle East where tensions are high. Internal conflict could erupt into violence that would imperil the flow of oil. Interruption of supply in the future, whether because of embargo or because of disorder, could throw our economies out of gear with spiralling losses in jobs and income.
- It is not only jobs and income that may be lost. It is also independence in making foreign policy. In an energy-hungry world, oil is power. It is not necessary for oil exporters to interrupt supply. The threat to close the spigot can be enough to persuade countries that depend to a high degree on imported oil to conform their policies to the wishes of oil suppliers.

For these reasons, the Governments of consuming countries must take positive action to achieve their dual objectives increased self-sufficiency in energy and a significant reduction in the price of oil.

Q: Granted the importance of stimulating domestic investment in energy, how would the "floor" price, or minimum safeguard price, do that job?

A: The so-called "floor" price, or minimum safeguard price, will be set at a yet to be determined level. Imported oil will not be sold domestically below that price level. The purpose is to assure domestic producers that their investments in conventional oil, gas, coal, and nuclear energy will not be jeopardized by cheap foreign oil if the OPEC cartel breaks and international prices come tumbling down, or if oil exporters decide to dump oil to undermine energy investments in consuming countries. Production costs in the Persian Gulf average 25 cents a barrel. This is only a small fraction of U.S. domestic costs. Persian Gulf producers thus have the capacity to price our own more expensive alternative sources right out of the market. Without some form of guarantee that they will be protected against a radical drop in OPEC price, businessmen might be reluctant to make major investments in new energy sources that would take several years to become operational.

Q: How would we prevent imported oil from being sold below the minimum safeguard price?

A: Protection could take the form of a tariff that would be levied on imported oil if and when its landed price (price at port of entry before customs clearance) fell below the safeguard price. The tariff could vary in amount depending on the spread between the safeguard price and the lower landed price. Quotas and fees could also be used.

Q: At what level would the minimum safeguard price be set?

A: The common minimum price would be set significantly below the current international price of oil but above the level prevailing before the Middle East war. (The current landed price in the United States is about $12 a barrel and the landed price in September 1973 was about $4 a barrel.) Tentative analysis suggests a price in the $6-8 range a barrel, but further technical work is needed before the level can actually be fixed.

Q: Won't the minimum price have to be very high to protect production of shale oil and other synthetic fuel?

A: No. The minimum price is intended to reduce price uncertainty for investments in conventional energy sources. These include Alaskan, North Sea, and Outer Continental Shelf oil, and conventional coal, gas, and nuclear energy. For shale oil and other synthetics whose costs are expected, at least initially, to be much higher, separate investment incentive arrangements will be necessary.

Q: Is the minimum safeguard price a price guarantee to OPEC as well as to domestic investors?

A: No, the minimum safeguard price is not a price guarantee to oil exporters. The price at which OPEC countries sell to consuming countries is likely to be well above this minimum for some time. But as production begins to flow from new investments in consumer countries and the supply of energy outside OPEC increases, the market for OPEC oil will contract. OPEC members will then be forced to compete for market shares. Competi-

tion will push down the price of oil. At that point the price that oil-exporting countries will receive may be below the minimum safeguard price.

Q: Won't the minimum safeguard price deprive IEA countries of the income and balance-of-payments gains of the new low price when the cartel breaks?

A: No. Importing countries would not lose the benefits of the lower international price if and when it falls below the minimum safeguard price. They would pay the exporting countries no more than the world price, however low it might fall, capturing the balance-of-payments and income gains of the lower price, while maintaining the minimum price internally to protect domestic investment.

Users of energy in importing countries would receive the benefit of any drop in world prices down to the level of the minimum safeguard price. The Government would get the benefit of any drop below the safeguard minimum; this would accrue to it as tariff revenue. Thus, if the minimum safeguard price were set, let us say, at $7 a barrel for imported oil, and if the landed price of imported oil (which is now about $12 a barrel) fell to $8, the U.S. importer would pay $8 a barrel. If, however, the landed price fell to $4 a barrel, the Government would apply a $3 a barrel tariff, the U.S. importer would pay the minimum safeguard price of $7 a barrel, the OPEC exporter would get $4, and the U.S. Government would get $3 a barrel.

One important benefit of the minimum safeguard price is that it would reduce the demand for oil that would otherwise occur if international oil prices should fall steeply. If, as in the example given above, the U.S. consumer were to pay the $4 landed price for oil instead of the $7 safeguard price, consumption would increase significantly and so too would imports. The cycle would begin again of growing reliance on cheap oil from unreliable sources. We do not want to see that happen again. Once is enough.

Projections calculated for the Project Independence Blueprint show the extent to which consumption is influenced by price. U.S. oil consumption in 1985 is projected under three different assumptions as to the price of oil to domestic consumers and suppliers:

- At a price of $4 a barrel (in constant 1973 dollars) the United States would consume a total of 29.8 million barrels a day;
- By contrast, at a price of $7 a barrel, we would consume 23.9 million barrels a day, or almost 6 million barrels a day less;
- At a price of $11 a barrel, we would consume 19.2 million barrels a day.

Q: Why not use subsidies to domestic producers as an alternative to a minimum safeguard price? This would enable domestic producers to compete with cheap imported oil and consumers to enjoy the lower world price.

A: Protecting domestic investors from loss, should the international price fall steeply, could be done either by a subsidy to producers or by a minimum safeguard price. In the former case, the taxpayer would pay for the subsidy; in the latter, the energy consumer would pay. But a system of subsidies that enabled consumers to buy imported oil cheaply would frustrate our objective of reducing dependence on insecure sources of oil. The low market price of oil, should the price break, would restimulate oil consumption and imports and make us vulnerable once again to supply interruption and price manipulation.

Furthermore, unlike the minimum safeguard price which yields tariff revenues to the Government, subsidy payments would be a drain on the budget, possibly a substantial one; the subsidy could vary widely depending on the world price of oil and it would be difficult to project the budgetary cost. In addition, by restimulating consumption and imports, the subsidy system would worsen our trade balance, causing a new outflow of dollars.

Q: Won't an across-the-board guarantee like the minimum safeguard price give unnecessary profits to low-cost producers?

A: As long as we have a market system with a single price, low-cost producers are going to do better than high-cost producers. This has always been true and remains so not only in this industry but in many others. The way to deal with differential profits is through the tax system.

Q: How does the minimum safeguard price protect the U.S. competitive position in world markets?

A: The members of the IEA are committed to encourage domestic investment in energy. Some members, like the United States and the United Kingdom, have larger oil, coal, or other land or offshore energy resources than do other members. They will be making major investments to develop these resources. Although these are conventional forms of energy, they are relatively high-cost, certainly by comparison with OPEC costs.

When these investments in new energy sources begin to add substantial amounts of new energy to the available world oil supply, the OPEC cartel will

come under increasing pressure. At some point the world price will break. At that stage, IEA members that have relatively little domestic energy production will be importing cheap oil again. In the absence of a common safeguard price, energy users in these countries would pay the lower world price for oil, thereby gaining a competitive advantage over energy users in member countries whose investments in relatively higher cost energy made the break in world oil prices possible.

The common minimum safeguard price will assure that no IEA member will gain a competitive advantage over other members because of the effectiveness of the IEA program in reducing world oil prices. Members have agreed in principle not to allow imported oil to be sold within their countries below a common minimum safeguard price.

Q: Won't the minimum safeguard price prove too costly for countries like Japan and Italy that will continue to depend on imported oil for the major portion of their energy?

A: No. Japan and Italy, like all other members of the IEA, would get the full benefits of the fall in the price of OPEC oil. Their balances of trade would improve as would their tax receipts. At the same time, energy users in their countries would pay the higher floor price for imported oil and be encouraged thereby to conserve. What these countries would lose is the competitive advantage their industry would otherwise gain over that in other IEA countries like the United States, Canada, and the United Kingdom whose major new investments in energy will help to bring down the international price of oil.

Q: What has this program to do with energy conservation?

A: The fundamental way to put downward pressure on the price of any commodity is to reduce demand and increase supply. These are two blades of the scissors which in combination can cut down the exorbitant price of oil. One blade—the conservation program directed to reducing demand has as its objective a reduction in U.S. oil imports this year of 1 million barrels a day and a reduction by the end of 1977 of 2 million barrels a day. The other blade—increasing supply by encouraging and safeguarding investment in energy—has been explained in this report. Restraint in energy consumption and increased energy investment and production will together help us achieve our objectives of greater self-sufficiency in energy and a substantial reduction in the international price of oil.

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The Case Against a Price Floor for Oil

(By Anthony J. Parisi)

Ever since Secretary of State Henry A. Kissinger proposed the concept of a price floor for oil traded on the world market, the U.S. has hammered away at its allies in the International Energy Agency to adopt it. Viewed superficially, the idea seems sensible enough: By agreeing not to import oil priced below some reasonable level, the IEA members could insulate their internal energy investments from a sharp drop in world oil prices. Under closer scrutiny, however, the idea loses much of its appeal.

If oil suddenly becomes cheap again, economists argue, why should consumers not take advantage of it? True, the domestic oil industry could suffer a severe setback, and relying once again on foreign oil might recreate the dependence that allowed oil prices to skyrocket in the first place. But there are simpler ways to overcome such pitfalls. The U.S. could restore quotas on foreign oil, for example. On the other hand, by committing itself now, the U.S. could lock itself into an agreement that it will want no part of in the future.

LITTLE ENTHUSIASM

Hardly anyone besides Kissinger and his negotiating team, headed by Thomas O. Enders, Assistant Secretary of State for economic and business affairs, seems to be enthusiastic about the idea of a price floor on oil. As a result, there is wide confusion as to its purpose. But experts offer three possible reasons for a price floor:

To insure development of petroleum substitutes such as shale oil and tar sands. But the floor levels now being considered—$6 to $8 in the U.S. and Canada—are too low to protect investments in substitutes. Companies with shale oil interests are not eager to invest even at today's prices.

To establish some objective long-term price for oil that the consuming nations could offer producers. But the IEA members have not been able to agree on a single price, and so far, the producing nations have ignored the suggestion that oil prices should be fixed at some lower level.

To encourage development of conventional oil and gas resources offshore and in other remote regions where exploration and production will be expensive. This seems the goal of the U.S. Yet, oil economists find little logic here.

For one thing, it assumes that without this protection producers will abandon their exploration. "But I haven't heard of one company that says it needs a guarantee to go after offshore oil," says John H. Lichtblau, director of the Petroleum Industry Research Foundation.

Of course, a precipitous drop in oil prices could make them regret their eagerness, but the oil companies seem willing to take their chances. "Can you talk about a floor price as a contingency without it eventually becoming a goal?" asks a spokesman for one major. "As a resource developer, we like to think of investing in terms of today's prices." The oil companies, in other words, would rather risk a price break than have the government set what the price should be, especially since it would be lower than it is now.

CRITICAL SUPPORT

While that viewpoint is obviously self-serving, it has the support of theoreticians as well. "Price controls are bad whether they're maximums or minimums," says Morris A. Adelman, an internationally known oil economist at Massachusetts Institute of Technology. Adelman is against the idea regardless of its purpose. "For guaranteeing domestic production," he says, "it doesn't make sense because no one knows what price will give you what response. When you set a floor, you're claiming knowledge that you don't have." He is even more strongly opposed to a price floor to negotiate a reduction with the oil producers. "What you're talking about then is a long-term commodities agreement," he points out, "and that's the worst thing we could do. We would be signing away our freedom of action. And signing a contract with a monopoly of sovereign states is simply ridiculous, especially since they've broken their word every time they've given it."

On top of these ideological objections, there are some convincing pragmatic arguments as well. For one, it would be extremely difficult to enforce such an

agreement within the consumer bloc. The IEA is not a homogeneous union of equally needy nations.

Why, then, does the U.S. keep pushing for a "price floor," "safety net," or "safeguard," as the scheme has variously been known? "From the U.S. point of view, any agreement is better than no agreement," says Enders. "Why should we develop high-cost oil for others' benefit? The other consuming nations will be better placed to take advantage of a collapse of OPEC prices, and that would give them a big advantage in international trade."

But that argument ignores history. All through the go-go years of the 1950s and 1960s, the U.S. competed quite successfully with the rest of the world, fueled mainly by its own high-cost oil. When domestic oil was supplying 80% of the nation's needs and selling for $3 a bbl., Japan was importing 100% of its oil for only $2 a bbl. Any advantage the Japanese may have had in international markets was due to other factors, because in that price range, energy is not a significant manufacturing cost. Moreover, if world oil prices collapse, coal prices would also fall, and that would benefit the U.S. much more than it would Japan or most Europeans.

"In the abstract," says Lichtblau, "Enders' argument is legitimate enough. But it's unreasonable to assume that foreign oil would fall so low as to undercut U.S. production costs, even on the Outer Continental Shelf." Oil companies gambling on offshore oil that they expect to sell for $11 would make less on their investments if prices fall, says Lichtblau, and they would be reluctant to continue high-cost exploration. But they would have no reason to stop producing what they had already found as long as prices stayed above $3 or so.

Adelman has a harsher reaction to the State Dept.'s reasoning: "Kissinger doesn't know anything about economics in general or the oil business in particular." In short, the problem with the price-floor concept may be that it is a solution crafted by diplomats, not economists.

KOPPERS CO., INC.,
Pittsburgh, Pa., May 6, 1975.

Re Gulf Oil Corp. testimony provided to the Joint Economic Committee, April 28, 1975; remarks submitted by Mr. William King, vice president and director of corporate policy analyses.

Hon. WILLIAM S. MOORHEAD,
House of Representatives, Rayburn House Office Building,
Washington, D.C.

DEAR BILL: At our meeting on April 30, 1975 where Koppers presented our coal gasification process to the Pennsylvania Delegation, you had requested that we submit a rebuttal to Mr. King's testimony to the subject committee.

Mr. King, in his testimony, under the heading of "Technical" stated that this technology has not been proven on a commercial basis: (he had reference to shale oil, coal gasification, coal liquefaction and related projects). At this point, Mr. King should have clarified his statement by advising the committee that he had reference to SNG (synthetic natural gas), pipeline quality gas, which is approximately 1000 Btu per cubic foot.

Koppers has been marketing our commercially-proven process for industry to substitute the K–T gas, which is 300 Btu per cubic foot. Mr. King is correct in that it cannot be mixed with natural gas because of the composition of the gas and because of its Btu value per cubic foot.

We are stressing to government and industry that large industry users of natural gas could be, or should be, taken off the natural gas pipeline and, in its place, construct a K–T gasification plant.

Please be assured that Koppers Company has contacted hundreds of industrial users of natural gas from Rutland, Vermont to San Francisco, California, and from Omaha, Nebraska to Houston, Texas. There are thousands of industrial users: steel industry, refractory industry, cement, foundries, chemical plants and, in fact, any industry which is presently using pipeline quality gas including, of course, the largest user—the electric utility companies. All of these industries can be taken off the natural gas pipelines and could easily convert to the commercially-proven K–T gas providing 300 Btu to their plants. This, of course, would reserve our natural gas for domestic and commercial use.

Reference your rebuttal to Mr. King, "right across the street from you, your friends from Koppers say that they have a coal gasification technology which

has been proven commercially." Mr. King's answer again confined himself to synthetic natural gas or pipeline quality gas but diverted himself somewhat in saying that he was aware of lower Btu or 300 Btu gas, and that it is *not a viable solution to our gas situation.* This is the remark to which we take issue. The Koppers-Totzek coal gasification *is a viable solution* to our gas situation. Not that it is interchangeable with natural gas, but it definitely is a *substitute* for natural gas. Mr. King and I'm sure the staff of people that we are working with at Gulf Oil are well aware of the potential of the K–T coal gasification process.

The average layman is not aware of the fact that in the range of 90% of our methanol and ammonia in this country is produced using natural gas as a feedstock. In addition, three trillion cubic feet of natural gas is consumed by the electric utility for generating electric power.

All of these consumers of natural gas, again, should be removed from our natural gas pipelines and should construct a commercially-proven gasification plant producing ammonia, methanol, gas for power generation and, as I stated above, practically every industrial user in this country could use the 300 Btu gas as a replacement for natural gas.

We hope these comments, along with our submission to the Pennsylvania Delegation Committee will be enough information for you to refute Mr. King's statements. We expect to review in more detail all of the above with Dr. Forscher on May 6, 1975.

May I take this opportunity to personally thank you for arranging our meeting with the Pennsylvania Delegation and reiterate that Koppers Company is not requesting that our Congress promote Koppers per se, or Koppers coal gasification process, but we as citizens of this country are concerned with the neglect in Congress in formulating an energy policy. If Congress is concerned with the unemployment of its constituents at this time, we can assure you that the unemployment that will hit this country within the next decade will be overwhelming unless we proceed immediately with an energy policy, and we feel that coal gasification can and will make a substantial contribution.

Very truly yours,

J. Frank Cannon,
Sales Department.

Chamber of Commerce of the United States of America,
Washington, D.C., March 27, 1975.

SUMMARY

The Chamber of Commerce of the United States of America strongly opposes the common price floor policy which the U.S. government has espoused in the International Energy Agency (IEA). Because of that policy's far-reaching domestic implications, we are disturbed that apparently no other meaningful options have been seriously considered. We urge that the government move quickly to do just that and that any decisions of this type be made in the context of an overall national energy policy.

BACKGROUND

At its February 30th meeting the Chamber of Commerce of the United States of America's Board of Directors accepted the position on the President's Energy Program suggested to it by its Natural Resources Committee. Among other policies, the Committee stated its support for the proposal that increases in energy supply be encouraged by assuring that the President has adequate authority to ensure that domestic price certainty can be maintained—such as authority to impose quotas, tariffs, and set price floors. This was clearly understood to support contingency powers for the President in the event of a precipitous drop in oil prices. It was *not* an endorsement of the downside risk policy currently being pursued by the U.S. in the International Energy Agency. The Chamber urges the Administration to consider the domestic implications of an international "safety net" policy to safeguard investment.

Risk-taking is central to the free market system. Nonetheless, it is clearly recognized today that the very magnitude of the investment required to develop non-traditional sources of oil and gas to develop viable alternative energy sources requires reasonable certainty of an adequate rate of return. In addition, reasonable certainty about energy prices is required for planning purposes in the U.S.

economy as a whole. Clearly, these were the concerns of the Natural Resources Committee when it put forward the policy quoted above.

Minimization of downside risk, reasonable price certainty, or whatever phrase one chooses to convey this idea can, however, be achieved by a variety of means. To our knowledge few of the options have been carefully examined. In addition we know of no instance in which policymakers have asked the advice of the business community about the price floor or any comparable policy, despite its far-reaching implications for the economy.

At the most recent meeting of the International Energy Agency, there was agreement in principle on setting a minimum price below which imported oil will not be sold in the members' domestic markets. The Governing Board will meet again to discuss actual minimum price figures some time after the preparatory meeting for the Producer-Consumer Conference in early April. The Chamber opposes a minimum import price policy at this time and in this context for several reasons.

(1) Of greatest importance, this policy sets a precedent for government interference in the market place that has long-term implications for our economic system.

(2) A price floor is not the only means to achieve price certainty and it is one of the most costly in both macro and micro terms because it restricts one of the market's major adjustment mechanisms.

(3) The achievement of this policy could well prove to be impossible because of the differing estimates of what price (or range of prices) will serve the purpose. This will waste valuable time needed to explore other options for the producer-consumer conference at the end of the summer. In addition, U.S. interests are likely to be undercut because most of our allies have fewer resources to develop than we do and thus would favor lower prices. And even if agreement is reached, there is no assurance that the price picked would be the "right" price from an investment point of view.

(4) Even if the U.S. did succeed in gaining agreement on a specific price, and the agreement did prove useful as a negotiating chip with the producers (even more unlikely), the policy is inflexible, taking away the freedom of maneuver of both government and industry in the long-term.

(5) This policy, as it will clearly impact on domestic energy policy, must be considered in the context of our overall energy planning, not as an unrelated question. This is a disturbing example of the setting of U.S. international policy without reference to the relationship to domestic policy and without consultation of national interest groups.

CONCLUSION

The Chamber agrees with the Administration and the Congress that the U.S. must reduce its vulnerability to cutoffs of foreign oil. In addition, we see the need for price certainty sufficient to generate the large amounts of investment necessary to achieve this end. However, there are a number of ways in which such a policy might be achieved, and in our opinion the common price floor is one of the least desirable. We urge policymakers in the executive and legislative branches to examine the broad range of options and to consider how they fit into our overall national energy planning. We stand ready to discuss how such actions would affect the business community, and emphasize the danger of making such far-reaching policy in a vacuum.

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